Taxes and Retirement in the State of Maine

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Prepared for the Libra Foundation
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Introduction

At the request of Governor Angus King, the State Planning Office published *A Golden Opportunity: How Maine Can Enhance The Retirement Industry* early in 1997. That report discussed the potential benefits to Maine of attracting and retaining a larger number of retirees, and inventoried Maine's many points of appeal to retirees and people contemplating retirement. The task force preparing the report observed that Maine's tax system, and particularly its highly progressive income tax, may tarnish the state's attractiveness. While endorsing some modest adjustments in tax provisions, *A Golden Opportunity* hesitated to prescribe large-scale income tax cuts as a central tactic for retaining Mainers approaching retirement and attracting retired newcomers. This was in part because the budgetary situation did not then permit significant tax reductions of any sort, and in part because the task force remained uncertain of the merits of such an approach.

Governor King has commissioned a new report on the broad issue of retirement in Maine. In support of that effort, the Libra Foundation has enlisted us to examine the specific dimension of taxes and retirement. While the Foundation helped to arrange access to Maine officials and citizens concerned with the issue, it has otherwise avoided any involvement in this project. Foundation President Owen Wells has stressed that our mandate is to produce a strictly independent inquiry, in hopes of better equipping Mainers for their own reflection and debates about the choices before them.

We first sketch Maine's fiscal profile in some detail, and compare it to the average for all states and that of two reference groups—the rest of New England, and a set of states considered particularly attractive to retirees. Next we examine the structure of state taxation in Maine, in the

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context of national trends in state tax policy. We then lay out the logic of using tax policy as a tool for attracting or retaining retirees. Finally, we tap several types of evidence to calibrate the potential for increasing Maine's population of retirees (especially more affluent retirees) through changes in taxation, and offer some concluding observations.

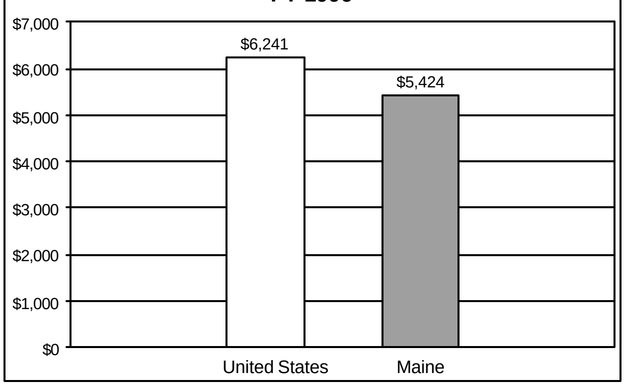
Maine's Fiscal Profile in Comparative Perspective[1]

Does Maine pursue high levels of public spending, fueled by taxes that are out of line with the burdens other states impose on their citizens? Some attention to this background question is an essential prerequisite to the subsequent focus on taxation's likely impact on retirement choices. The answer to this apparently simple question—is Maine a high-tax, high-spending state?—is more complex than one might expect, and depends on the precise perspective one takes. This section engages the question from several different angles. All of them, though, are *comparative.* Absolute levels of taxing and spending are not very illuminating. If the question is how current and potential retirees perceive Maine, and how that perception can affect their behavior, what matters is Maine's fiscal picture relative to at least three benchmarks:

- the average for *all* states;
- other New England states;
- and states that compete with Maine as magnets for retirees.

It is also important to present an *integrated* fiscal picture—including both state and local finances—so that real differences (or real similarities) aren't obscured by variations across states in how the boundary between state and local responsibilities happens to be drawn. For example, in Maine (as in many states) state-level taxation exceeds local taxation by a substantial margin; in New Hampshire, state tax revenues are less than half as large as local tax revenues. Failing to consider both levels of taxation would lead to a grossly distorted picture of the relative burden of government.

Figure 1: State and Local Spending per capita, FY 1996

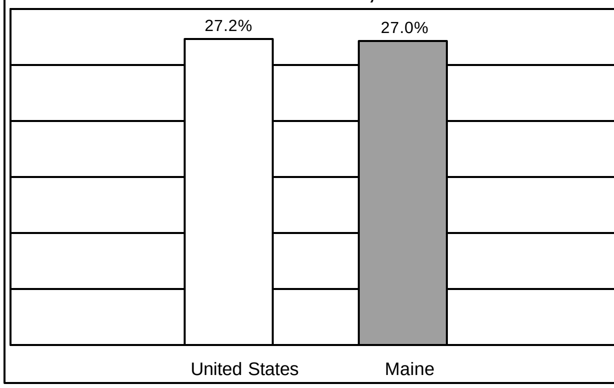


The Census Bureau's Governments Division—acting in concert with a very large number of state and local financial organizations—assembles an admirably complete and consistent compilation of financial data for state and local government. Standardized information is available on each category, and some quite detailed sub-categories, of state and local spending, taxes, and other revenues (including transfers from the Federal

[1] This section is based on data from U.S. Department of Commerce, Bureau of the Census, Governments Division "Finance Estimates for State and Local Governments, 1996." The source files are 96stlss1.txt and 96stlss2.txt, accessed in July and August 1999 at http://www.census.gov/govs/www/estimate.html, processed by John D. Donahue and formatted in chart form by John D. Donahue and Scott Barkan.

government.) This level of detail and standardization comes at the price of timeliness, however. The most up-to-date *state* fiscal data are for FY 1998, while the most recent data for state and local government *combined* are for FY 1996. A state's basic fiscal profile rarely undergoes radical short-run changes—Maine's has not—but the vintage of the data should be kept in mind when reviewing this section.

Figure 2: State and Local Spending as a Share of Personal Income, FY 1996

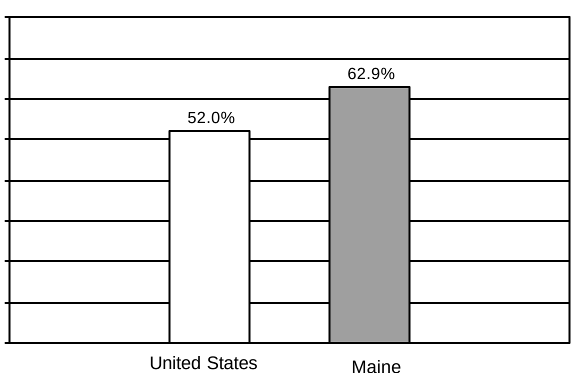


Maine Relative to the All-State Average

Maine's public sector—state and local government combined—spent a total of about $5,424 per person in fiscal 1996. This was over $800 *less* in *per-capita* public spending than the national average of $6,241. (See Figure 1.) Maine's spending for primary and secondary education—the largest claim on state and local budgets—was almost precisely the national average ($1,048 for Maine; $1,051 for the country as a whole) while its higher-education spending was a little below average ($315, compared with $380.) It spent considerably more for "welfare" broadly defined ($1,025 versus a U.S. average of $731), much of this reflecting vendor payments for Medicaid. Unsurprisingly for a large and thinly populated state, Maine spent more than the national average for highways ($392 versus $298.) But it undershot the national average in enough areas (including utilities, police and fire, and corrections), and undershot it by a large enough margin, to rack up total *per-capita* spending that was just 87 percent of the average for all states.

So by this broadest measure—overall public spending—Maine looks quite a bit thriftier than the norm. But Maine is also quite a bit less affluent than the norm. A more meaningful measure of government's ambitions and cost may be public spending relative to personal income. By this metric, Maine hits the national benchmark almost precisely: In the U.S. as a whole, state and local spending came to 27.17 percent of personal income in 1996. In Maine, it came to 27.02 percent. (See Figure 2.) While Maine is almost exactly at the national average for public spending relative to private affluence, it departs from the norm in the division of labor between state and local government. While the separate states display an enormous range of variation in how this boundary is drawn, on average state government spends a little over half of the total. In Maine, the state share is considerably higher—closer to two-thirds than to one-half. (See Figure 3.)

Figure 3: State Share of Combined State and Local Spending, FY 1996



So the picture thus far is of a state whose public-sector spending—scaled to its citizens' means—is very close to the national norm. But that public-sector spending is significantly tilted to *state*, rather than *local*, spending—again, relative to the national norm. If every unit of government spent only the money it raised itself, if all spending were financed by taxes, and if all public budgets were precisely balanced every year, we would have already said a lot about Maine's fiscal profile. But state and local finance is considerably more complicated: Cities and states spend not only their own money, but also money they get from Washington, and from each other. Nor is taxation the only way cities and states raise their own money.

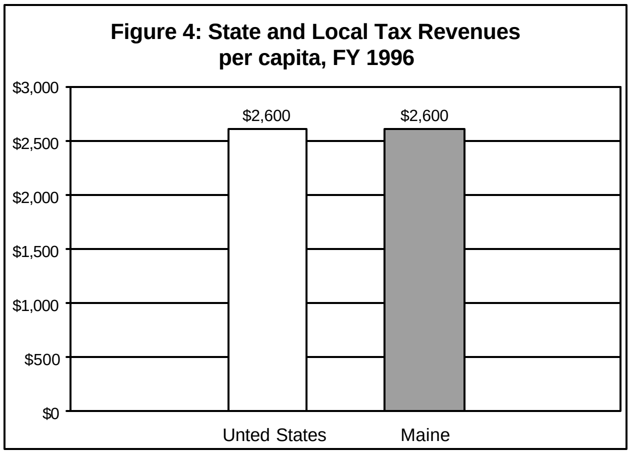


Figure 4: State and Local Tax Revenues per capita, FY 1996

Maine's combined state and local tax burden was the same (to the nearest dollar) as the national average: $2,600 *per capita.* (See Figure 4.) Since Mainers earn somewhat less than the national average, however, this means that their *per capita* tax burden is on the high side. Total state and local tax revenues were 12.9 percent of personal income in Maine, compared with 11.3 percent for the U.S. as a whole.[2] (See Figure 5.) And the state share of state-local taxation was a little lower than the national average—about 59 percent of the total, compared to about 61 percent. (See Figure 6.)

This seems peculiar, at first glance. How can it be that Maine is *below* the national average in spending, but *at* the national average in taxing? (This is in *per capita* dollar terms; the story can be stated differently, but no less puzzlingly, in terms of the percentage of personal income, where Maine is *at* the national average for spending but *above* the national average for tax revenue.) And how is it that in Maine the state share of the state-local total is unusually *high* for spending, but a notch *below* the norm for tax revenue?

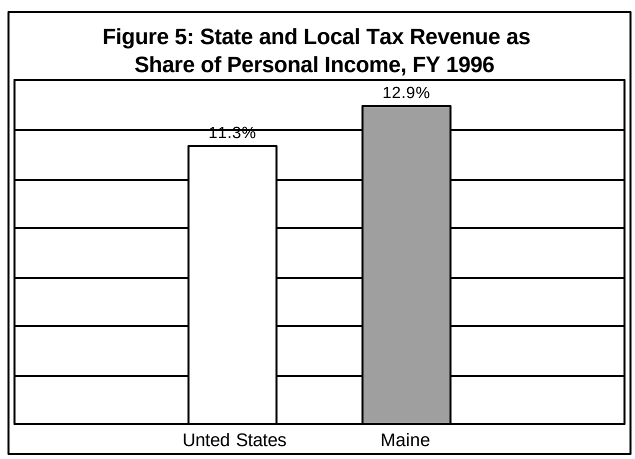
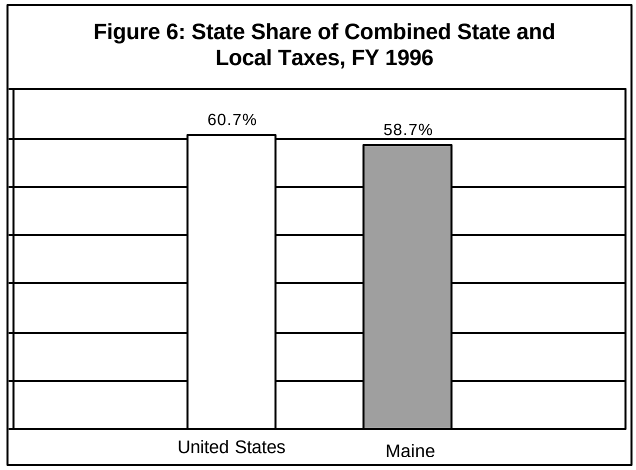


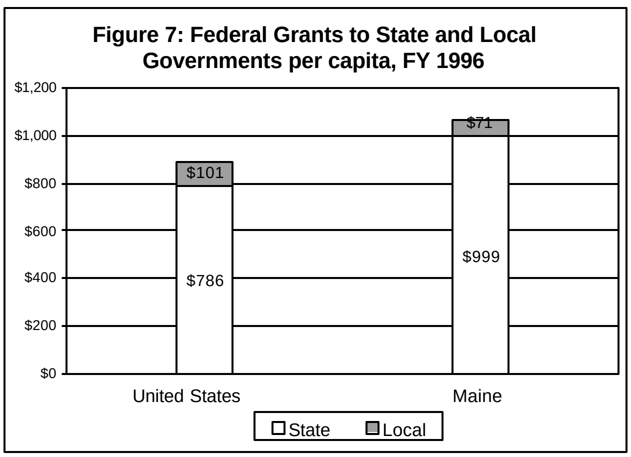
Figure 5: State and Local Tax Revenue as Share of Personal Income, FY 1996

Much of the explanation lies in intergovernmental grants—transfers of resources *between* governments. A great deal of what is conventionally termed "Federal spending" is allocated to cities and

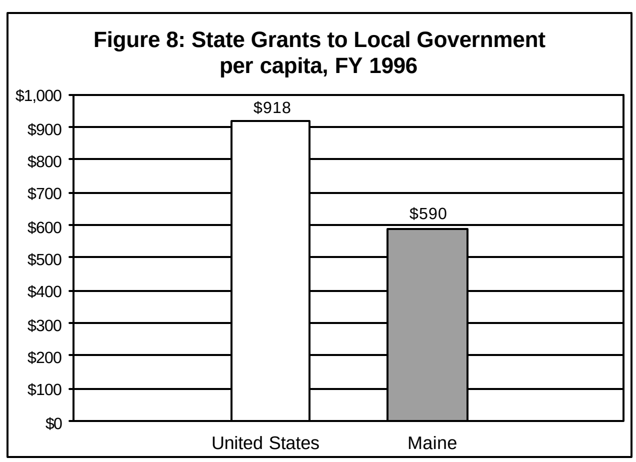
[2] This does not mean that all Mainers, or even the average Mainer, paid 12.9 percent of income in state and local taxes. Some taxes are paid by out-of-staters; some taxes are levied on business income, rather than personal income. This is simply a way of calibrating tax burdens relative to a state's general level of affluence. The National Tax Foundation has published figures for 1999 that show a higher *per capita* state and local tax burden for Maine—13.84 percent, ranking the state third in the nation. Maine's heavy reliance on progressive taxes *does* mean that its relative tax burden has probably risen faster than average during the late-1990s boom, but the Tax Foundation figure needs to be taken as tentative. For purposes here, we rely on the dated but more definitive Census Bureau figures.

states, rather than spent by Federal agencies, and roughly a seventh of all state and local endeavors are funded by transfers from Washington (or, more precisely, funded by citizens with Washington as the conduit.) Cities and states rely on Federal grants to help pay for a vast range of activities, including providing health care to low-income people, building and maintaining highways, supplementing school budgets, training workers, and supporting needy families. Maine is no exception. But its pattern of receipts from Washington departs somewhat from the average. Averaging all states together, state governments collected $786 *per capita* in Federal grants in 1996, and local governments collected $101 *per capita.* But Maine's state government received 27 percent *more* than the *per capita* average for all states, while Maine's local governments received 30 percent *less* than the average. (See Figure 7.) Maine seems to be somewhat more likely to lodge at the state level those governmental operations that are eligible for federal funding.

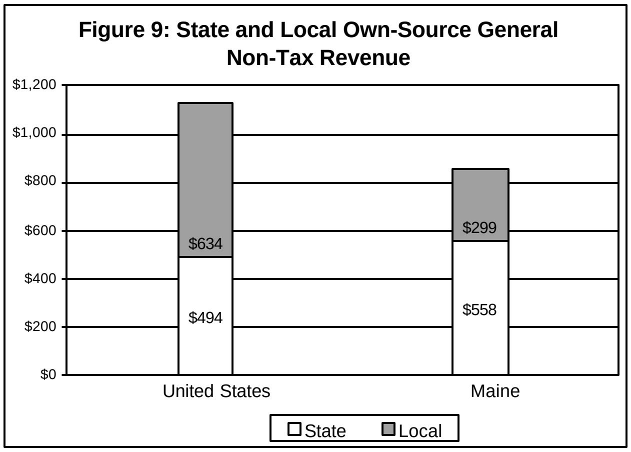




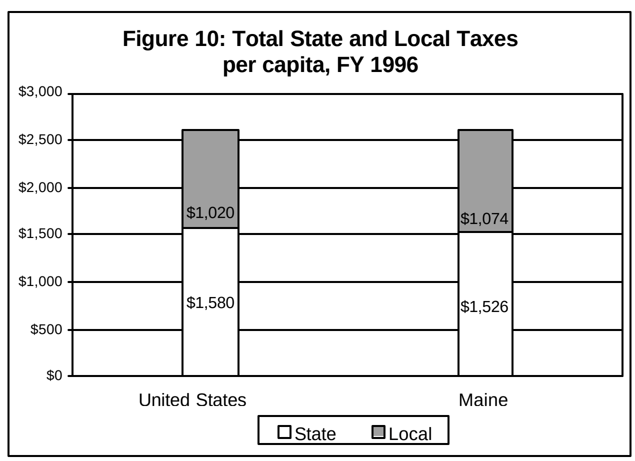
The bias toward the state in funds from Washington helps to explain why state government carries out a large share of the spending, but doesn't do a large share of the taxing, within Maine's public sector. Another part of the explanation can be found in transfers from *state* to *local* government. On average, state-to-local grants were $918 *per capita* in Fiscal 1996, exceeding the scale of Washington-to-state grants for the nation as a whole. But in Maine, state transfers to local government were much lower, at $590 *per capita.* (See Figure 8.) Not only does state government in Maine control some Federally-funded undertakings that in other states are run by local governments. The state government also tends to carry out state-funded functions itself, rather than sending the responsibility (and the money) to cities, towns, and counties.



The apparent mystery of a state government that accounts for a large share of the spending but *not* a large share of the taxing is much clarified once intergovernmental grants are taken into account. Another part of the explanation concerns revenues *other* than taxes. This is a broad, diverse slice of America's overall state and local fiscal picture. Non-tax revenue can include everything from state lottery proceeds and interest on bank deposits to fees collected by public colleges or hospitals and fines levied on overdue books at a local library. The distinction between a tax and other transactions that increase government assets is often rather murky. The interesting point, for present purposes, is that Maine's public sector collected only three-fourths as much non-tax general revenue, on a *per capita* basis, as the national average. But while Maine's state government collected somewhat *more* non-tax revenue than the mean, its local governments collected less than half as much as the national average. (See Figure 9.) What explains the relative shortfall in local revenues other than taxes? No single factor accounts for it, but several items stand out. Local governments in Maine collect little revenue from public hospitals ($35 *per capita* in 1996, *versus* a national average of $132), earn relatively little interest income ($38 *versus* $109), and collect less than the average from school lunches, fees and other charges related to education. Scant non-tax revenues reinforce the basic picture of a relatively modest local-government sector. While Maine's state government spent very close to the national average on wages and salaries for public workers (a wage bill of $490 *per capita* in 1996) local governments spent $328 *less* than the national average of $1,199. In short, Mainers tend to do without some common local public services, or to rely on state government or the private sector for an unusually large share of services that elsewhere tend to show up in local government spending.

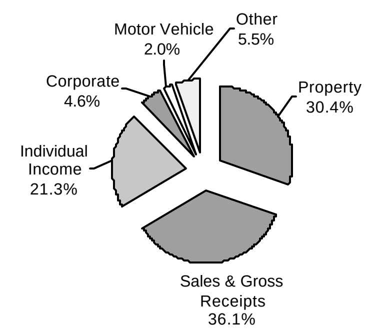


The basic fiscal story so far is that Maine's public sector spends at about the national average (relative to personal income) but spends *more* at the state level and *less* at the local level. This is largely because state government collects more than average from Washington, and local governments collect less than average, while the state spends relatively little to underwrite local governments. And state government collects somewhat more non-tax general revenue than average, while local government collects a good deal less. We can now narrow the focus to *taxes*—the central subject of this report. As we observed earlier, Maine is very close to the national average in *per capita* state and local taxation, and somewhat above the average in state and local taxes relative to personal income (12.9 percent versus 11.3



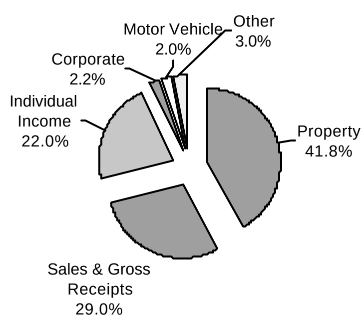
percent.) It is not far from the norm in the shares of total taxes levied by state *versus* local government. The state collects a little less than average ($1,526 *versus* $1,580), while local governments—somewhat more reliant on their own levies than local governments elsewhere—collect a little more ($1,074 *versus* $1,020.) (See Figure 10.)

Figure 11: Per Capita State and Local Taxes, U.S. Average FY 1996 (total = $2,600.42)



Consider next the *composition* of Maine's state and local taxes. Figures 11 and 12 allow a comparison of the major categories of state and local taxation in Maine, and the average for the U.S. as a whole. One noteworthy observation is that the 1996 *per capita* tax burden in Maine, rounded off to the nearest whole dollar, was precisely the national average--$2,600. Another is that Maine's portfolio of state and local taxes departs quite substantially from the typical pattern.[3] Property taxes account for a much larger share of the total—nearly 42 percent in Maine, compared with just over 30 percent on average. Sales taxes are a smaller fraction of Maine's tax revenue (29 percent *versus* 36 percent.)[4] Corporate income taxes account for 4.6 percent of state and local taxes nationwide, but just 2.2 percent in Maine. Interestingly, despite Maine's high income tax rates, individual income taxes contribute only a slightly larger share of state and local tax revenue in Maine (22 percent) than the national average (21.3 percent.)

Figure 12: Per Capita State and Local Taxes, Maine FY 1996 (total = $2,600)



Maine has a reputation, both within and beyond the state, for progressive taxation. (A tax system or an individual tax is considered *progressive* if it claims a larger share of high incomes than of low incomes, *regressive* if it claims a larger share of low incomes, and *proportional* if it takes the same fraction of income across the spectrum.) The Census Bureau data are broadly consistent with this view, but with some exceptions and nuances worth noticing. The burden of sales taxes tends to fall with disproportionate weight on less affluent people, because better-off people devote more of their incomes to saving, and to spending on services (as opposed to goods.) So Maine's sparing use of sales taxation fits with the reputation for progressivity. Maine's heavy reliance on property taxation—almost all of which is local, rather than state—is generally, but not completely, consistent with this progressive pattern.

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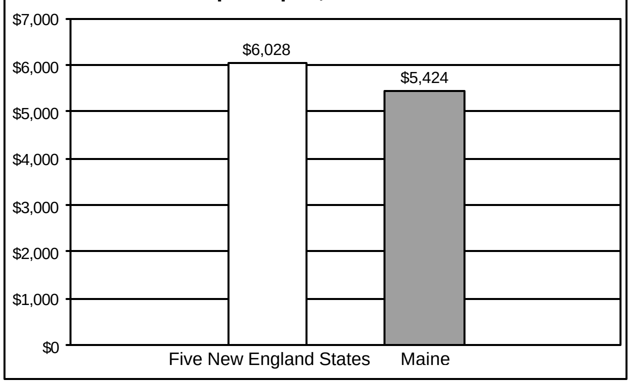
[3] No state, of course, is precisely <u>at</u> the national average, and each maintains its own distinctive balance among categories of taxes.

[4] The recent legislation cutting the sales tax rate in Maine is likely to reduce this further.

Property taxes do tend to be proportional to income; richer people are likely to own more property, and hence pay more property taxes. But less affluent people can pay a higher *share* of their incomes in property taxes, if they live in a property-poor town with high tax rates, or if their property holdings are disproportionately high relative to their incomes (as is often the case with older taxpayers.) Business assets as well as personal property are subject to property taxes, and while some business owners are well-off, others are not. While the homestead exemption and other measures buttress the progressive tendencies of Maine's property taxation, the distribution of this tax's burden is more complex than it may at first appear to be. It is worth underscoring that the relative importance of local property taxes in Maine tends to limit the leverage that can be exercised by changes in *state* tax law.

Maine's lower-than-average reliance on corporate income taxes, and its close-to-average reliance on individual income taxes, may seem to run counter to this reputation for progressivity. But corporate taxes are a low (and falling) share of state taxes nationwide, making this a relatively minor part of the picture in any event. Moreover, there is considerable uncertainty about how their burden is ultimately shared among customers, shareholders, and other groups. It *is* somewhat surprising to see that individual income taxes are so modest a share of the total tax bill. Yet it is important to remember that the *per capita* average tax bill can obscure enormous variation in a tax system's impact across different categories of taxpayers. As will be discussed shortly, the structure of Maine's tax system can allow income taxes to swamp other categories of taxation for some citizens.

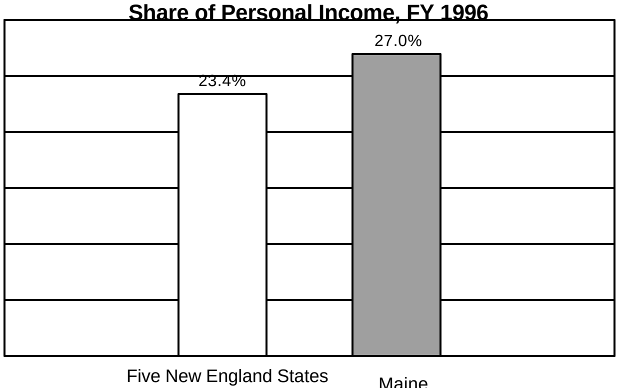
Figure 1A: State and Local Spending per capita, FY 1996



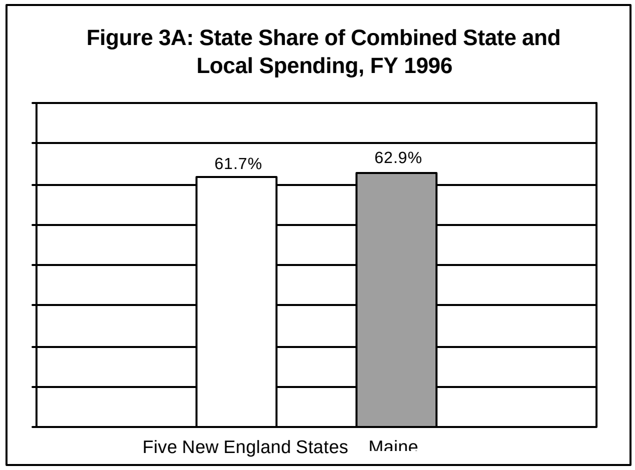
Maine Relative to the Rest of New England

This section briefly compares Maine's fiscal profile with the average for the other five New England states of Connecticut, Massachusetts, New Hampshire, Rhode Island, and Vermont. This five-state average conceals much variation among the New England states, from Massachusetts (with its relatively high taxes and spending) to New Hampshire (a famously tax-averse state.) Yet it turns out that there is a characteristic New England pattern across many parts of the fiscal picture. Within the region New Hampshire, rather than Maine, tends to depart from the pattern.

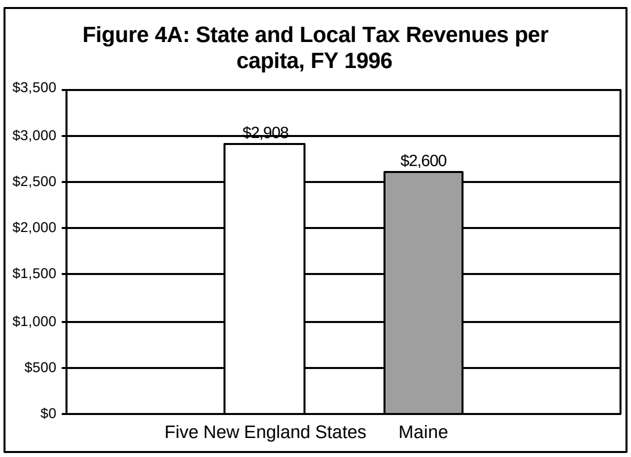
Figure 2A: State and Local Spending as a Share of Personal Income, FY 1996

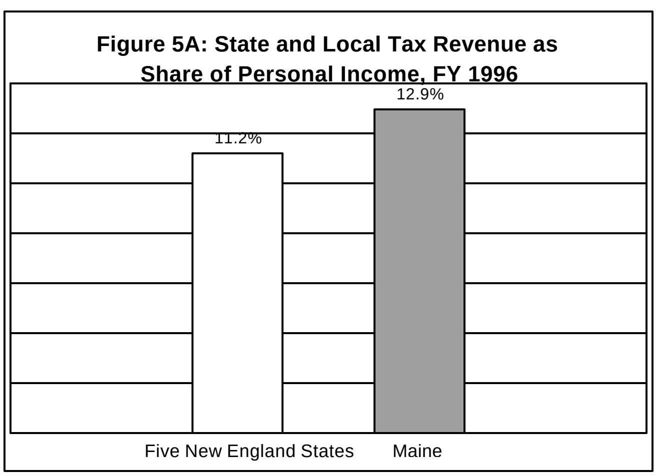


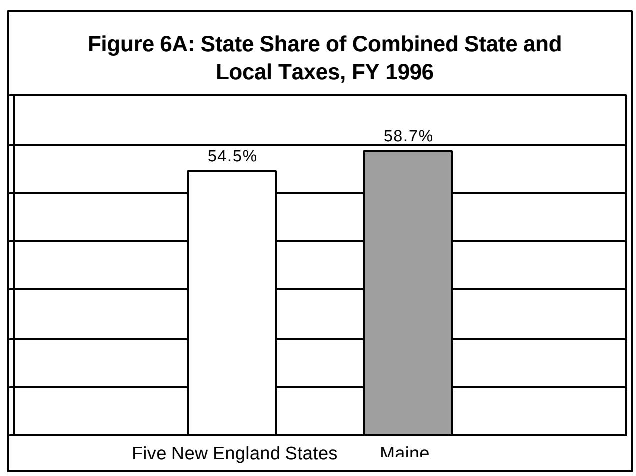
State and local spending *per capita* is actually *lower*, for New England on average, than for the country as a whole. As Figure 1 above shows, average FY 1996 state and local spending was $6,241 *per capita.* It seems surprising that New England would outpace the rest of the country on public-sector thrift, but much of this is due to the relative rarity of government-owned hospitals and utilities in New England. On average, cities and states spent $616 *per capita* on public hospitals and utilities, while New England spent $337. In dollar terms, Maine's spending per person is lower than the other New England states, but relative to personal income Maine's public spending outpaces the rest of New England. Maine fits the New England pattern (and departs from the national average) in state government's high share of state and local spending.



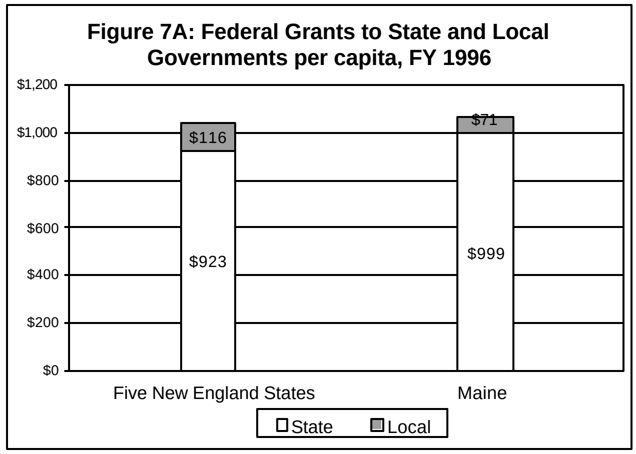
On the narrower issue of state and local taxation, Maine imposes a smaller burden than the rest of New England on a *per capita* basis, and a higher burden relative to personal income. Recall from Figure 6, discussed earlier, that *state* taxation in Maine accounts for a lower-than-average share of the state-local total (58.7 *versus* 60.7.) Figure 6A shows that the other New England states display an even *lower* share of state taxation in the total.

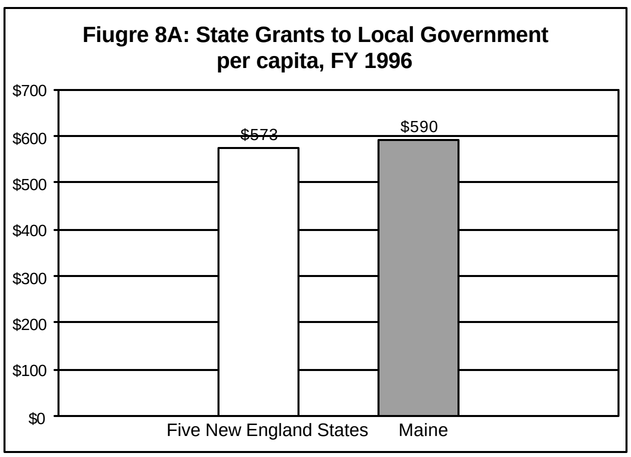


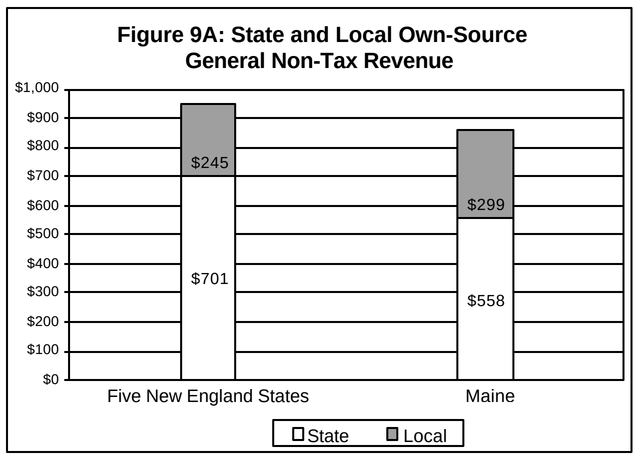




While local governments in New England tend to collect higher levels of Federal grants than the national average, in Maine local governments collect less. But Maine slightly exceeds even the high New England average in Federal grants to *state* government. Maine fits the New England pattern in its lower-than-average levels of state grants to local government. On the issue of own-source general revenues other than taxes, Maine is lower than the other New England states, which are themselves well below the national average.[5] But Maine fits the New England pattern (and departs from the national pattern) in its unusually low *local* share of non-tax revenues.







[5] The relative rarity of public hospitals and utilities in New England explains some of this; hospital charges and utility bills are important categories of non-tax revenues.

Maine looks like the rest of New England (and unlike the national average) in the relative importance of different categories of taxes. The New England states tend to rely very heavily on property taxes (which are mostly levied by local government), and make modest use of sales taxation. New England states as a group depend on corporate income taxes to about the same degree as the national average, or about twice as much as does Maine. And the New England average for individual income taxes as a share of all state and local taxation—pulled down by New Hampshire—is somewhat *lower* than the national average (20.7 percent versus 21.3 percent) and significantly lower than Maine's 22 percent.

Figure 10A: Total State and Local Taxes per capita, FY 1996

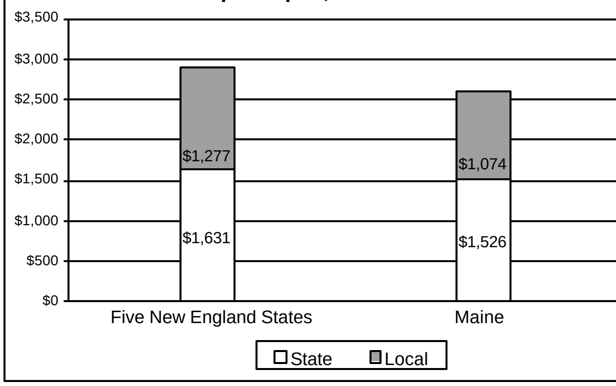


Figure 11A: Per Capita State and Local Taxes, Five New England States FY 1996 (total = $2,908)

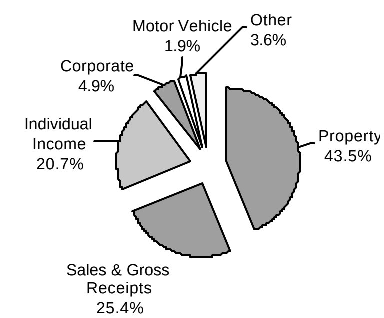
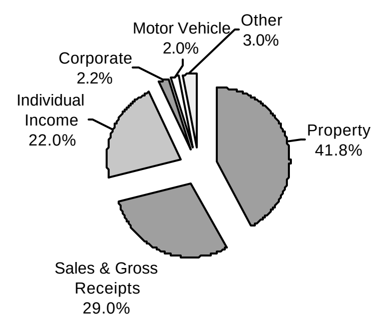


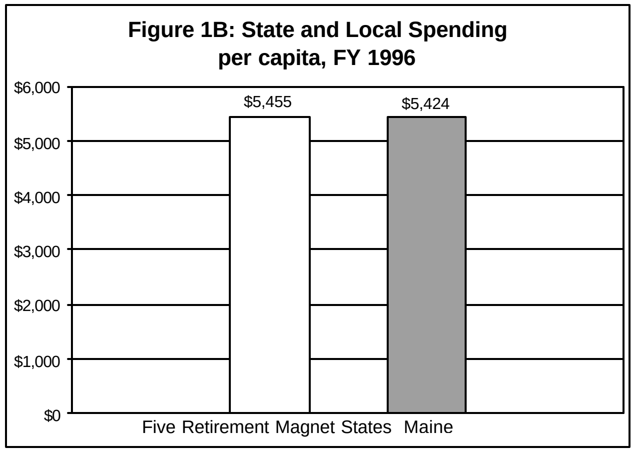
Figure 12A: Per Capita State and Local Taxes, Maine FY 1996 (total = $2,600)

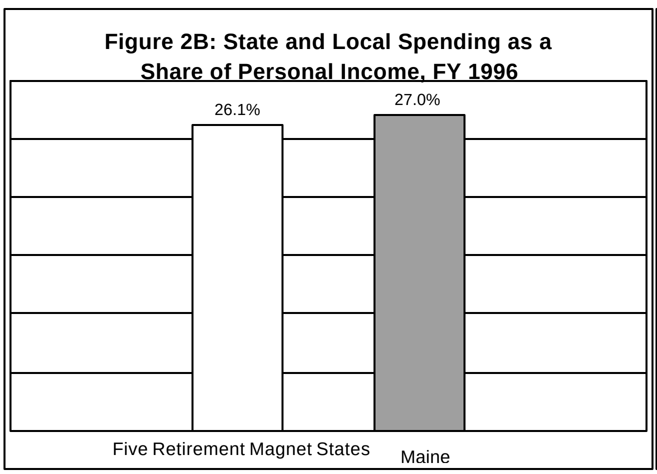


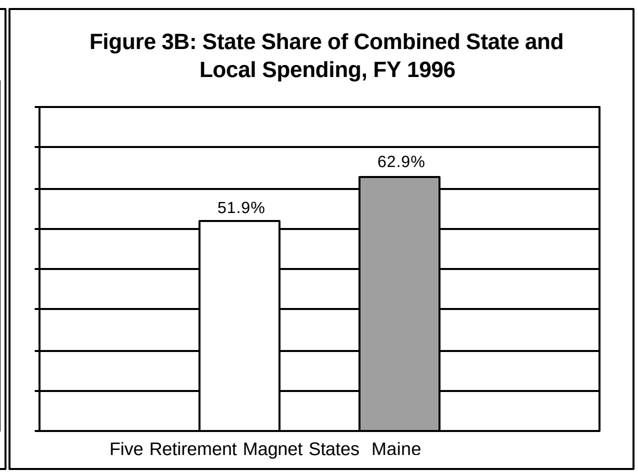
Maine Relative to Other "Retirement Magnets"

Shaped by a common history and culture, on most fiscal dimensions Maine resembles the rest of New England in its taxing and spending patterns. The previous section's comparisons are useful for understanding Maine's current fiscal profile. But another set of comparisons may be more germane to discussions of how those patterns would need to change—the direction of the change, and the distance—if Maine chose to focus on taxation as a tactic in its competition for retirees. This section compares Maine with a group of states outside New England that are considered "retirement magnets"—states that draw a disproportionate share of relocating retirees, or hold reputations for being especially hospitable as retirement locales. The comparison set of “retirement magnets” outside New England includes Arizona, Florida, North Carolina, South Carolina, and Virginia.[6]

Like Maine, the selected retirement magnets have lower-than-average public spending on a *per capita* basis. Unlike Maine, they also display lower-than-average levels of public spending relative to personal income (though the gap is a modest one.) These states share the national pattern of rough parity between state and local government expenditures—a pattern from which Maine departs, with its outsized state share of total spending.

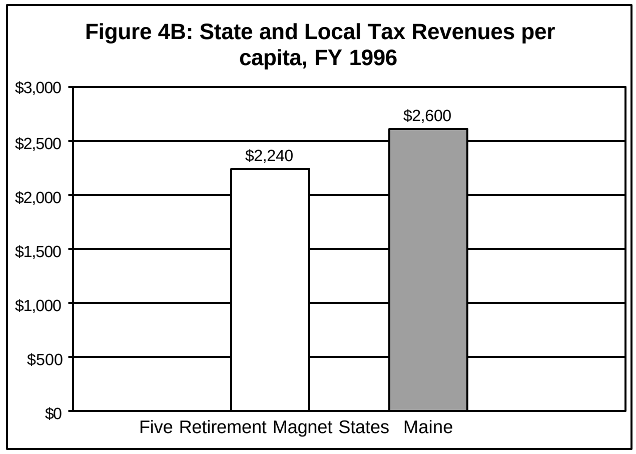




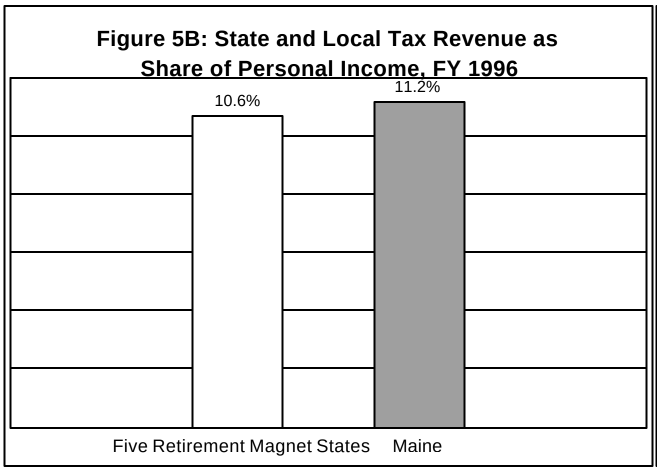


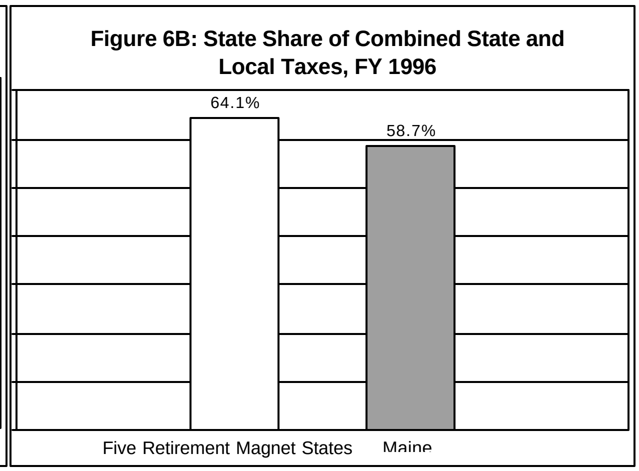
[6] The states included in this reference set are the four states outside New England selected for comparison in the tax section of *A Golden Opportunity: How Maine Can Enhance The Retirement Industry*, with the addition of Virginia, a prominent destination for military retirees.

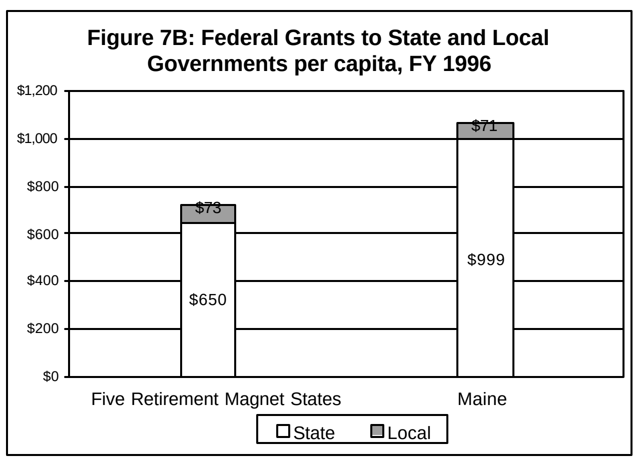
As a group, the retirement magnets levy state and local tax burdens that are somewhat lower than Maine's (and lower than the national average) both on a *per capita* basis and relative to personal income. State taxes are a higher share of the state-local total in the retirement magnet group than in Maine.



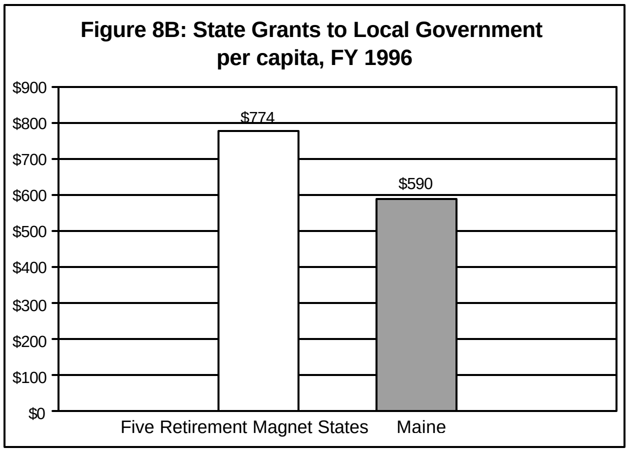
The retirement magnet group, like Maine, has lower-than-average levels of Federal grants to local government. But while Maine shows unusually *high* levels of Federal grants to state government, the retirement magnets feature unusually low levels.[7] State grants to local government tend to be low in the retirement magnets, though not as low as in Maine. And on the issue of own-source revenues other than taxes, the retirement magnets display the opposite pattern from Maine: Local non-tax revenues above the national average, state non-tax revenues below the national average. In general, this reference group presents an exaggerated version of the national average, where the state share of *taxing* exceeds the state share of *spending*. In Maine, by contrast, Federal grants and non-tax revenues accrue disproportionately to the state, and state grants to local governments are limited.

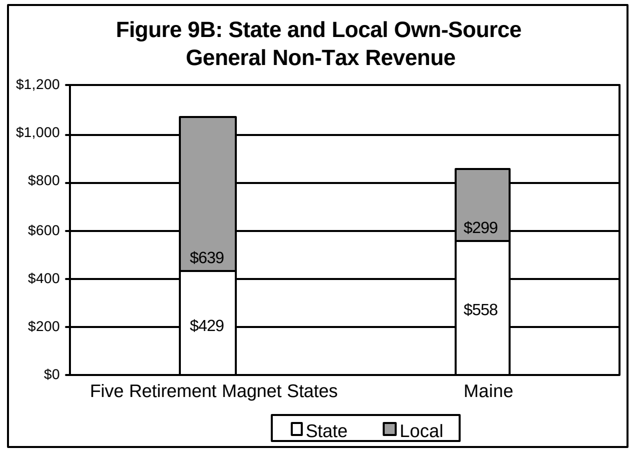




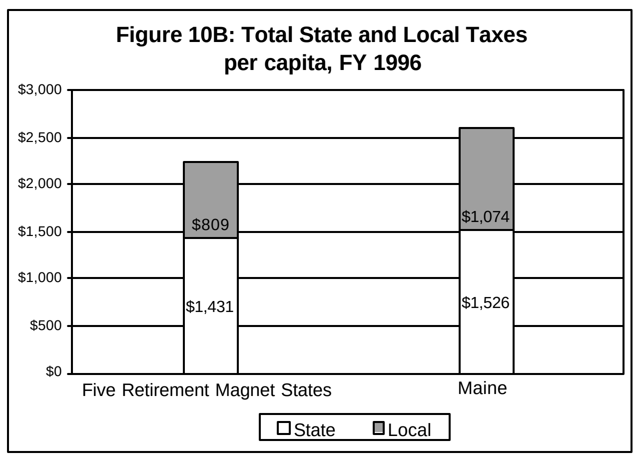


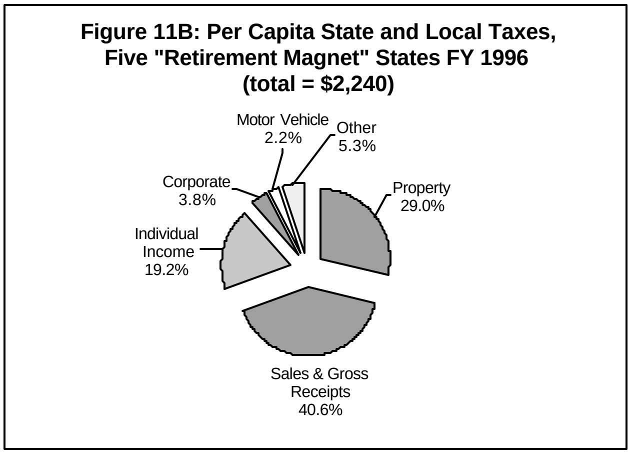
[7] This is in part because of Maine's higher-than-average highway spending, on a *per capita* basis, and partly because of categorical Federal grants that are roughly proportional to a state's own anti-poverty spending, which is high in Maine and generally low in Arizona, Florida, the Carolinas and Virginia.

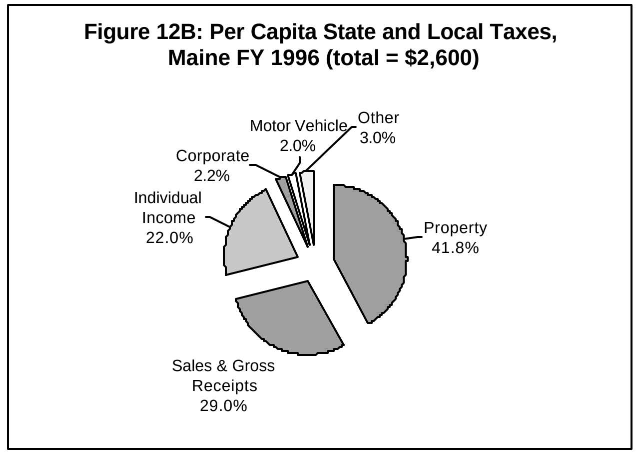




The *per capita* state tax burden averages about $100 lower in this group than it does in Maine. But at the local level, the average tax discount relative to Maine is more than two and a half times as great--$1,074 in local taxes for Maine, and $265 lower, on average, for the retirement magnets. Comparing Figures 11B and 12B explains this gap: These five states make exceptionally light use of (mostly-local) property taxes, and exceptionally heavy use of sales taxes. Maine departs from the national pattern in precisely the opposite way. The difference between Maine and these five states in income taxes is noticeable, but far more modest (at least in terms of *per capita* averages): In Maine, individual income taxes are 22 percent of state and local taxation (a bit above the national average) while in the reference group individual income taxes account for 19.2 percent of the total. As will be discussed at more length below, the *per capita* picture can conceal large, and potentially consequential, variation among categories of taxpayers. But it is interesting to observe that the big distinction between Maine and the average for Arizona, Florida, the Carolinas and Virginia concerns the balance between local property taxes and state sales taxes, with the income tax share a secondary area of difference.



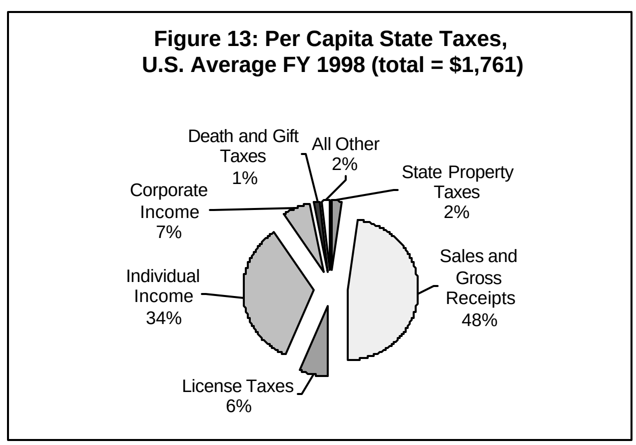




A Closer Look at State Taxation in Maine[8]

The focus now shifts to state taxation, rather than state and local combined. This allows us to use more recent comparative data, since Census Bureau figures are available for state taxation up to Fiscal Year 1998. It also concentrates more precisely on the question of whether changes in state tax policy can improve Maine's appeal to retirees. But the narrowing means that we miss a large part of the "price" of being a Mainer, and some of the most important ways in which government's burden differs between Maine and other states.

Maine's *per capita* state taxation was $1,901 in 1998. This was about the average for New England, about $140 higher than the average for all states, and about $325 higher than the average for the five "retirement magnets" outside New England. While states vary tremendously in the relative importance of different categories of taxation, the two biggest slices are typically sales taxes (which tend to be regressive) and individual income taxes (which tend to be progressive.) For the country as a whole, sales taxation accounted for 48 percent of the *per capita* tax burden in 1998, and individual income taxes accounted for 34 percent. The most striking difference between Maine and the five retirement magnet states (in terms of state taxes alone) is in their symmetrical directions of departure from the

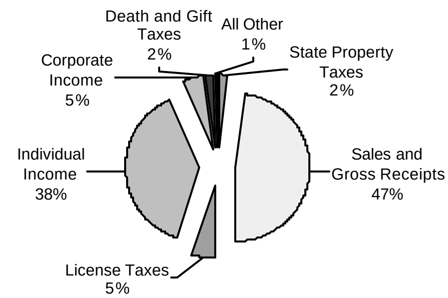


[8] This section draws on on-line and printed data from the National Tax Foundation, the Census Bureau, the National Tax Association, the Federation of Tax Administrators, and on information provided directly from Maine Revenue Services.

national average on these two taxes. As a group, the retirement magnet states raise 52 percent of their state tax revenue from sales taxes, as opposed to Maine's 47 percent. The five states rely on individual income taxes for 32 percent of tax revenue, *versus* 38 percent for Maine.

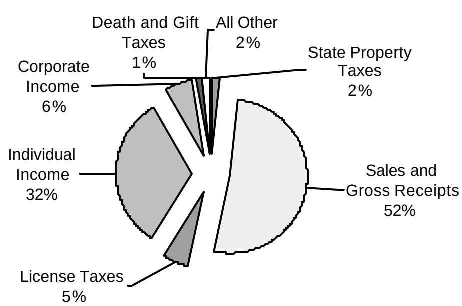
The following section discusses some pertinent details of Maine's state taxation, including both the major items—sales and individual income taxes—as well as smaller categories of taxation.[9]

Figure 14: Per Capita State Taxes, Maine FY 1998 (total = $1,904)



Sales Taxes: Maine raises much more revenue from "general" sales taxes ($668 *per capita* in 1998) than from "selective" taxes levied on particular types of transactions ($249.) The two most important selective sales taxes are on gasoline, where Maine's tax rate is around the national average, and tobacco, where Maine's tax is somewhat higher than average. Maine's general sales tax rate is in line with the national average—indeed, following a rate cut in 1998, it is slightly on the low side. Thirteen other states tax general sales at the same 5.0 percent rate that Maine will levy starting next year. Sixteen states have higher sales tax rates; fifteen have lower rates; and five have no general sales tax at all. The sales tax base is quite narrow, covering only tangible goods and exempting sales of most services. Concentrating on goods rather than services—a practice Maine shares with most other states—tends to make the sales tax somewhat more regressive than it otherwise would be. Tilting it in the other direction is the fact that food and drugs are both exempt from taxation—an exemption that is not offered by many of the states with lower rates than Maine's. This combination of a narrow base and a restrained tax rate—and, possibly, the frugality that puts a lid on the typical Mainer's consumption—account for the limited contribution sales taxes make to Maine's state revenues.[10]

Figure 15: Per Capita State Taxes, Five "Retirement Magnet" States FY 1998 (total = $1,574)



Corporate Income Taxes: Corporate income taxation accounts for about five percent of Maine's state tax revenues, compared with about six percent for the retirement magnet states and about seven percent for all states. This lower-than-average share is partly due to differences in corporate profits recorded in a state, and partly due to a corporate tax system that is less

[9] This section makes extensive use of comparative data, as of July 1999, assembled by the Federation of Tax Administrators and published on-line at http://www.taxadmin.org/.
[10] While this issue extends beyond the mandate of our report, we find it surprising that Maine makes such limited efforts to shift the sales-tax burden toward tourists and seasonal residents.

aggressive than in some other states. The rate starts at 3.5 percent and rises through four brackets to reach a maximum of 8.93 percent. Twelve states have higher top rates on corporate income than Maine's. In all of these, the top rate is either a "flat" levy on all corporate income, or begins at or below the $250,000 threshold for Maine's top corporate bracket.

Individual Income Taxes: Maine has a notably progressive individual income tax system. The top rate of 8.5 percent is exceeded by only seven states (and matched by one, Minnesota.) Moreover, Maine's top state tax bracket is reached at relatively low income levels--$16,500 for an individual, and double that for a married couple filing jointly. Only in Oregon can a taxpayer face a higher marginal rate at a lower level of income.

In addition, Maine employs a sweepingly inclusive definition of income. Capital gains, for example, are treated the same as ordinary income. There is a large and contentious academic literature on whether this makes sense. Some analysts argue that capital gains should be taxed more lightly, in order to stimulate investment and reward enterprise. Many believe that at a minimum, measured capital gains should be adjusted for inflation, to avoid taxing phantom increases in value. But other analysts point to the complexity, waste, mischief, or unfairness that can be triggered by treating capital gains in a different way from labor income or other types of investment returns. (The special issue of capital gains is taken up again at the end of this report.)

Of at least equal relevance, for purposes of this report, is Maine's treatment of retirement income.[11] Among the 41 states with broad-based individual income taxes in 1996, most (including Maine) exempted Social Security benefits from taxable income. (None of the "retirement magnet" states taxed Social Security benefits, although two New England states—Connecticut and Vermont—did so.) While the Federal income tax exempts all Social Security benefits at lower income levels, it taxes a fraction of the benefits of higher-income retirees. Maine simply excludes Social Security from taxable income. (A short-lived legislative initiative in the spring of 1999 would have shifted Maine's tax code to federal treatment—partly taxing Social Security benefits for higher-income beneficiaries—but was vetoed before it took effect.) But that is the extent of Maine's special tax consideration for retirement income. The AARP lists Maine as one of only eight states offering no exemption for any retirement earnings that are counted as Federal adjusted gross income, including military and civilian Federal pensions, state and local retirement benefits, and private pensions.[12] (Like the other seven states in this category—with the exception of Connecticut—Maine does offer some form of special tax treatment for older taxpayers, in Maine's case a state tax credit equal to 20 percent of the federal tax credit for the elderly.)

Of the five "retirement magnet" states, Florida has no individual income tax, so the issue of special treatment for pension income is irrelevant. Three of the others—Arizona, North Carolina, and South Carolina—excluded a portion of pension benefits (ranging from $2,500 to $10,000) from taxable income. The remaining "retirement magnet," Virginia, offered an age-based partial exemption for all income, whether derived from pensions or other sources.

[11] This section draws heavily on *State Taxation of Social Security and Pensions in 1996* by David Baer of the American Association of Retired Persons Public Policy Institute. It does not reflect the post-1996 state tax changes catalogued below.
[12] The others were California, Connecticut, Nebraska, Ohio, Oregon, Rhode Island, and Vermont.

Taxpayers between 62 and 64 could exclude the first $6,000 of income from taxation; those over 65 could exclude the first $12,000. (In each case, joint filers could double the exclusion.)

Post-1995 Tax Reductions in Other States

The states endured nearly a decade of budgetary stress starting in the mid-1980's, and enacted net increases in taxation during every legislative year from 1986 to 1994. Some of these increases were steep, particularly those introduced during the last recession. Net state tax increases in 1990 approached $10 billion; the next year's total tax increases exceeded $16 billion.[13] The tide turned in 1995, as political and economic developments led to net state tax reductions of $3.3 billion nationwide. The tax-cut tide strengthened through the late 1990s, with four sequential years in which tax reductions exceeded tax increases at the state level. The net reduction was $4 billion in 1996, $2.6 billion in 1997, and a remarkable $7.1 billion in 1998[14]

While there have been notable reductions in many categories of state taxation—including disproportionate cuts in corporate income taxes and less-than-proportionate reductions in sales taxation—a large share of the reductions have been in individual income taxes. The Appendix to this report describes all of the state income tax reductions with a net effect of $50 million or more enacted between 1995 and 1998.

The Appendix also describes all income tax reductions, including those below the $50 million threshold, that target (or disproportionately benefit) retirees or older taxpayers. Nineteen such tax cuts were enacted during the four-year period. In 1995 both Kentucky and Iowa enacted new or expanded exclusions on pension income, and Virginia liberalized its age-based income exclusions (as described above.) In 1996 Michigan allowed senior citizens to claim larger exemptions for interest and dividend income, Oklahoma introduced a partial pension exclusion, and North Carolina enacted a special retroactive refund for pension taxation during the 1980's that subsequently was found Constitutionally questionable. In 1997 Connecticut introduced somewhat more generous treatment for Social Security, Delaware liberalized its pension exclusion, Missouri introduced a pension deduction, North Dakota, Ohio, and Wisconsin enacted preferences for some health-care expenditures—which were not focussed on retirees, but may have been particularly significant for older taxpayers—and South Carolina raised the maximum deduction for taxpayers 65 and older. And in 1998 Missouri liberalized several small age-based tax preferences, North Carolina introduced a tax credit for long-term care insurance[15], and Delaware, Georgia, Iowa, and New Jersey expanded their tax preferences for retirement income.

[13] National Conference of State Legislatures, *State Tax Actions 1995*, Figure 1, p. 3.
[14] *State Tax Actions 1998*, Figure 1, p. 1.
[15] Maine has had such a credit since the early 1990s.

The Tilt Toward the Top in Maine's Tax Burden

Maine's tax system disproportionately depends on local property taxes and individual income taxes, and relatively little on sales taxes. This pattern is the legacy of many separate decisions, made by many different public officials and accepted by citizens, over a long history. It shares the general pattern of the other New England states (aside from New Hampshire) but displays many distinctive Maine details. And it is quite different from the pattern that characterizes Arizona, Florida, the Carolinas, and Virginia. Mainers have chosen to tilt the burden of paying for government towards more affluent people to a greater degree than the average state, and to a much greater degree than New Hampshire or the retirement magnets outside New England. This, rather than the slightly higher level of *average* taxation, is what most clearly distinguishes Maine, in ways that worry some citizens.

Recall that sales taxes account for about 36 percent of state and local tax revenue nationwide, for a U.S. total of roughly half a trillion dollars. Maine has chosen to go light on sales taxation, and this has consequences for distribution. The burden of sales taxation tends to be shared more evenly than other kinds of taxes. It is true that better-off people often spend more money than less affluent people, and so generally pay somewhat more in sales taxes. But (especially since sales taxes tend to miss most services) a citizen's sales tax liability increases only modestly as his or her income rises. So sales taxes are generally regressive—taking a greater fraction of small incomes than large ones. And some sales taxes, such as tobacco taxes, fall more heavily on low-income citizens in absolute terms, not just relative to their incomes.

Per capita state sales tax revenues in Maine came to a little over $775 in 1997, according to Census Bureau state finance data.[16] It would be misleading to suggest that every Mainer contributed precisely this amount, or even very close to this amount, in sales taxes. The poorest, or the most frugal, may have spent so little on taxable goods that they contributed only a hundred dollars to the sales tax total. The richest, the most free-spending, or those at a stage in life involving major purchases may have paid several thousand. A back-woods hermit, or a determined tax smuggler, could conceivably avoid sales taxes entirely. But there are built-in constraints on consumption—both upper and lower limits to what's possible—that put some boundaries around how much anyone is likely to depart from the *per capita* average.

That same year, *per capita* individual income tax revenues were about $620. In contrast to the per-person figure for sales taxes, however, this tells us next to nothing about how heavily the income tax weighed on any particular individual. Administrative data from Maine's Bureau of Taxation for that year illustrate how skewed toward the top of the income scale is the actual burden of this tax.[17] The Bureau organized the 572,260 income returns it received into ten groups of equal size, or "deciles," arranged in order of income. The lowest tenth of tax returns, for example, reported adjusted gross income of $3,667 or less. The highest tenth had income

[16] Census Bureau state finance data from http://www.census.gov/govs/state/97stme.txt, accessed September 1999. Local sales tax data for that year are not available, but the previous year local sales taxes contributed a trivial share of the total.

[17] "Maine Individual Income Decile Report, Tax Year 1997, all filers" Printout dated January 10, 1999 and supplied to authors by Michael Allen of Maine Revenue Services.

exceeding $65,704. The Bureau then recorded the income tax liability for each of these "deciles" of 1997 tax returns. (Since the majority of the returns were for married couples or heads of households, the following figures are not directly comparable to the per-capita figures derived from Census data that are discussed above.) The decile reporting the lowest incomes had an income tax liability averaging $16 per return. Not until the fourth decile, with income between $16,902 and $22,075, did average income tax liability exceed $100.

But Maine's progressive tax code means that the income tax rises very steeply as income increases. The fifth decile, just below the average income for all returns, had an average tax liability of $392. The sixth, just above the average income, had an average liability of $658. By this point the top rate of 8.5 percent was in effect for each incremental dollar of taxable income for most returns. Maine taxpayers in the next-to-highest decile, with adjusted gross income of $47,908 to $65,703, owed an average of $2,436 in income taxes. And the top decile, with incomes exceeding $65,704, owed an average of $7,970. This top ten percent of taxpayers bore nearly fifty-six percent of the total income tax liability. These comparisons illustrate why Maine's unusually heavy use of income taxation and light use of sales taxation shifts the burden of financing state government toward higher-income Mainers.

This becomes even clearer when the top ten percent of tax returns is itself sorted by income, as the Bureau of Taxation has done. Table 1 summarizes the average income tax liability for each fifth of the top ten percent of taxpayers—each group consisting of 11,445 tax returns, most of them joint returns for married couples.

Table 1

Fraction of top 10% of 1997 Maine tax returns	*Adjusted Gross Income Range*	*Average Income Tax Liability*
Lowest fifth	$65,704 to $71,605	$3,347
Second fifth	$71,606 to $79,816	$3,883
Middle fifth	$79,817 to $93,739	$4,667
Second-highest fifth	$93,739 to $128,777	$6,284
Highest fifth	$128,778 and up	$21,670

A Maine couple with income in the high five figures, who probably do not think of themselves as particularly wealthy, can confront an annual state income tax bill roughly equal to the cost of a good used car. At the very top of the income range the income tax bill can equal or exceed a year at the priciest private college. It is true that taxpayers who itemize their deductions—as do many, but by no means all, high-income people—can subtract most of what they pay in state income taxes from their Federal taxable income. This softens the blow somewhat. But it is nonetheless clear that even if Maine's taxes may not be grossly out of line *on average*, income taxes can loom large for high-earning Mainers.

It would be quite surprising if higher-income Mainers, including those who consider themselves simply middle class, did not occasionally grumble about income taxes. Many Mainers—not just the wealthiest—vacation outside the state during the winter. It is easy to see how a Maine couple, returning from the vacation cottage in late winter and starting the tax paperwork, might muse about making a switch: Why not *reside* in some warm, low-tax state, and *vacation* in Maine?[18] Most younger people—anchored by jobs or children in school—will quickly dismiss the thought. But retirees, or those contemplating retirement, may take it more seriously. Some surely follow through on the idea, just as some seasonal Mainers avoid becoming residents for tax reasons. The question is whether such decisions are common, or rare, and what the net consequences would be of rendering Maine's tax system more hospitable to better-off retirees.

Assessing Tax Strategies for Attracting and Retaining Retirees

Would Maine benefit by changing its tax system to keep more retired Mainers and to induce more out-of-staters to retire in Maine? We first lay out the logic of answering this question, and then turn to some relevant evidence.

The net consequences of a tax reduction aimed at increasing the number of retirees can be most simply described as:

- *the number of retirees who stay or settle in Maine BECAUSE OF the tax change*
- *TIMES the average net benefit to Maine of an extra resident retiree*
- *MINUS the revenue Maine gives up* <u>*without*</u> *changing anyone's behavior.*

We will attempt to clarify each of these elements in the following sections.

The Net Gains to Maine of Extra Retirees

The middle element—the average net benefit of keeping, or gaining, a retiree who would otherwise reside elsewhere—has several components. The most obvious is income tax revenue. Consider someone who is completely retired, and hence has no Maine-source earned income that would be subject to taxation regardless of residency. Suppose that this retiree's pension and investment income are high enough that (under current law) he would face a Maine income tax liability of $5,000. And suppose that he therefore maintains his legal residence elsewhere, carefully managing his calendar to spend less than half his time in Maine. If a tax-code change reduced his Maine liability to $4,000, *and* if this changed his mind about Maine residency, then the $4,000 would be a revenue gain for Maine.

Maine also stands to collect auto license and registration fees from the majority of incremental retirees. It can expect eventually to collect additional estate taxes, if the extra retiree

[18] It is similarly easy to imagine how a vacationing out-of-state family might be charmed by Maine and contemplate settling there, but give up the dream after consulting the tax code.

remains a lifelong Mainer and leaves a large estate. Local government may collect higher property taxes, if the retiree's home ownership raises overall property values.

The extra retiree is likely to bring benefits to Maine beyond extra taxes. If residency means that he spends more time in Maine than he otherwise would, he and his family will almost certainly spend more on locally produced goods and services. Even if his time in Maine doesn't change greatly, his spending on certain services—such as banking or legal services—is likely to increase if he becomes a Maine resident instead of a visitor. He may also be more inclined to invest in Maine businesses, or to engage his expertise as a formal or informal counselor. And he may be more likely to make (or maintain) charitable contributions in Maine than he would be if he remained (or became) a visitor rather than a resident. Moreover, there are gains to keeping or attracting retirees beyond economic ones. Extra resident retirees can enrich Maine's culture and civic life, and may spend more time with family and friends than they would if they were required to keep an eye on the calendar to maintain non-resident status.

On each of these dimensions, however—the public fisc, the private economy, and civic life—there can be losses to other Mainers, as well as gains, from an extra retiree. State and local government will have to provide more in certain kinds of services. Well-off retirees may bid up housing prices in some areas. Their priorities could diverge from those of younger or poorer people, complicating the task of reaching community consensus. Even if the net gain for other Mainers from keeping or attracting an extra retiree is likely to be positive, these offsets are real.

Two overarching observations warrant emphasis at this stage.

First, not all of the benefits (and costs) retirees bring to other Mainers depend on legal *residence* in Maine. Some—including income taxes—clearly do. Others, such as auto registrations or banking and legal services, are very strongly associated with legal residence. But some, such as sales taxes paid and the broader effects of engagement with Maine's economy, are more or less proportional to time spent in Maine. If a non-resident retiree spends 49 percent of her time in Maine, other Mainers get 49 percent of the benefit; likewise if a resident retiree spends 51 percent of her time in Maine. And other impacts are related to residency in subtle and hard to measure ways. A native Mainer who spends part of the year in Florida may, or may not, abandon the habit of contributing to Maine charities if she changes her legal residence. A retired out-of-stater with a Maine summer home may, or may not, share business expertise and contacts with local entrepreneurs. Legal residency improves the odds of many kinds of benefits accruing to Maine. But few of these categories have the all-or-nothing characteristic of taxes on retirement income.

Second, most of the benefits and losses associated with incremental resident retirees are, in principle, measurable. But they can be estimated with varying degrees of precision. It is very easy to estimate net benefits badly.[19] It is quite difficult to do it well. The likely payoff to

[19] To take just a couple of the many estimating hazards: It may seem that local property taxes paid by a retiree should be counted as a benefit to Maine of his residency. But this would only be true if the retiree would not own the property if he were a part-year resident, and that the value of the property would be appreciably lower if it were in the hands of an alternative owner. Similarly, the prospect of collecting estate taxes is a real benefit of attracting or keeping a resident retiree. But the value of this benefit depends upon the length of the retiree's life, the probability that he will remain in Maine until death, the size of the estate at death, the status of Federal and Maine

attempting to pin down the average net benefit per retiree greatly depends on the other parts of the picture: The probability of altering retirement decisions by changes in tax policy, and the consequent revenue losses. If the odds of changing a retiree's location decision are high, or if the cost of changing the tax code to induce more retirement is low, then the net benefit of an incremental retiree becomes a very interesting issue. If it is very difficult or very expensive to alter retirement decisions, conversely, calibrating the precise benefit becomes somewhat academic.

The Impact of Taxation on Retirement Location Decisions

If "taxation is the price we pay for civilized society," then state and local taxation can be thought of as the price of enjoying civilization in one particular bit of terrain rather than another. And taxes that depend on formal residence can be thought of as the premium to be paid for the extra advantages of citizenship.

Some location decisions are highly sensitive to differences in tax levels; others are not. The influence of an interjurisdictional tax differential depends on two kinds of considerations. One is the scale of the difference in the net tax bill between two alternative locations. The other is the importance of taxation relative to other locational considerations. Even modest tax differentials can drive location decisions if there are only trivial differences between alternative locales on other dimensions. Conversely, if locales differ significantly on dimensions the decision-maker cares a great deal about, even very large tax differentials may be irrelevant.

While state and local taxes will never be the *only* consideration in business location decisions, for example, they often matter. Taxes directly affect after-tax profit, an important item for most businesses. As the American economy shifts toward services and goods produced with modest investments in hard-to-move capital, and as communication and transportation technologies improve, it would be logical to expect taxes to matter somewhat more in business location decisions. When cities and states become closer substitutes for each other—because of weakening dependence on local sources or markets—differences in "price" become more important. There is some evidence that this is occurring.[20] At the other extreme is our own institution, Harvard University. As a non-profit organization, Harvard is sheltered from many (though not all) state and local taxes. (Personal income taxes, for example, do affect the University's labor costs.) The practical and managerial costs of moving the institution would be immense. So it would take an extremely large tax differential to influence the University's choice of location.

There is not much of a literature, unfortunately, on the question of retirees' responsiveness to income tax differentials, although the basic question is readily framed.[21] How

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estate-tax law at the time of death, the skill and aggressiveness of the retiree in structuring the estate to minimize taxation, and the time value of money during the years before the estate tax revenues are realized. It is also worth noting that Maine real property is subject to Maine estate taxation even for non-residents.

[20] The Appendix of *Disunited States* (John D. Donahue, Basic Books, 1997) summarizes some of the evidence and arguments on this issue.

[21] While there has been a great deal of scholarly work on the broad question of migration in response to policy differences across jurisdictions, most of this is focussed on corporations, the general population, or welfare

is the number of Maine retirees (whether natives or newcomers) affected by the level of income taxation?

Ignoring, for now, state goals *other* than tax revenue, the challenge can be stated as reducing tax *rates* up to the point where the extra revenue collected from the very last resident to buy in because of the tax cut equals, or just exceeds, the revenues surrendered through the very last fraction of a percent of tax-rate reduction. This is comparable to the challenge an airline faces in setting its ticket prices. Higher prices mean more revenue from each passenger, but more empty seats. Lower prices fill the plane, but reduce the profit per head. Airlines that prosper are those that become skillful at striking the right balance, and realistic that the right price may not fill every seat.

Airlines have learned that they can do better if there is not a single price, but a range of rates that take advantage of passengers' differential responsiveness to cost. Some passengers have urgent business and no other options, and are ready to pay a lot. Others may be traveling on a whim, or have many alternatives in how or when they travel, so a few dollars' difference will determine whether or not they buy. Airlines work hard to set ticket terms and conditions that charge high prices to the first group, and charge low prices to the second. The more clever the airline is at structuring its pricing scheme (and the less successful are passengers at beating the system) the higher the airline's profit and the smaller the waste of empty seats.

The ideal for the airline, of course, would be to somehow know *exactly* what the trip is worth to each passenger, and setting the ticket price on a person-by-person basis. The woman with no other options to reach the lawyer's office in Duluth before the deadline passes for claiming her inheritance would be charged $100,000. The man thinking he might like to drop in on his cousin would be charged the cost of the extra fuel and peanuts, plus a penny. Failing omniscience, and complete discretion in setting prices, an airline's pricing system will fall short of its ideal: Some seats will go empty, and some passengers will be charged less than what they would be willing to pay.

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recipients. (A good early example of this more general literature is Michael J. Boskin, "Local Government Tax and Product Competition and the Optimal Provision of Public goods," *Journal of Political Economy* volume 81, number 1, January-February 1973.) Our previous work in this area, supplemented by a thorough literature search conducted specifically for this report, identified only four attempts to empirically calibrate the responsiveness to tax differentials of older people's residency decisions. One showed that when one of Australia's states abolished death duties which remained high elsewhere, it gained a higher share of elderly Australians. (Philip J. Grossman, "Fiscal Competition Among States in Australia: The Demise of Death Duties," *Publius* 20, number 4, Fall 1990.) Another looked at elderly whites (among many other groups) and found them to be more likely to leave a state with high property taxes or high welfare spending, but otherwise not very responsive to taxing and spending. (Richard Cebula and R.M. Kohn, "Public Policies and Migration Patterns in the United States," *Public Finance* 30, 1975) A third found that elderly in-migrants were more likely to choose states without any income taxes. (Richard Cebula, "A Brief Empirical Note on the Tiebout Hypothesis and State Income Tax Policies," *Public Choice* 67, 1990.) The most recent and most directly relevant study of elderly migration controlled statistically for climate, crime, the cost of living, and other factors that might affect older people's residency decisions. It found that a high share of property taxes or income taxes in a state's fiscal profile seems to encourage out-migration of the elderly. But puzzlingly, it found that the very same factors seem to encourage *in*-migration of the elderly, to at least an equal degree and with at least equal statistical significance. (Karen Smith Conway and Andrew J. Houtenville, "Do the Elderly 'Vote With Their Feet?" *Public Choice* 97, 1998.) The scholarly literature, in sum, is something short of conclusive on the issue.

The State of Maine is not an airline, of course, and no civilized tax system would aim to squeeze each citizen up to the point where they're ready to flee across the border. But the analogy may be helpful to illustrate several important and potentially elusive points. Citizens, like customers, differ in their responsiveness to the "price" of taxation. If citizens differ but tax rates are uniform, Maine is certain to lose some current or potential retired residents whom it would prefer to keep or attract. Many of those "lost" retirees offer benefits to other Mainers that would amply justify reducing their taxes—even offering them subsidies—to induce them to retire in Maine. But it does not follow, sadly, that such a deal can be struck. The key question is the balance between the number of people who will reside in Maine *only* if their income taxes are lowered to some specified degree, and the number of Mainers who will benefit from the tax reduction but will not make any change in their behavior.

The challenge flows from the fact that taxpayers differ both in their *circumstances* and in their *preferences*. For some, the preferences will be decisive for where they settle in retirement. For the middle-income taxpayers who are dyed-in-the-wool Mainers, with their hearts set on spending their retirement years in their own town near the neighbors they have known for decades, tax considerations will be virtually irrelevant. Their post-retirement incomes are modest, and the tax savings they could reap by moving to some other state will be trivial in comparison to what they would have to give up–neighborhood, friends, community–to obtain it. On the other extreme of the "preferences" scale, some older citizens are so firmly determined to flee the winter, once cut loose from work and family anchors, that no imaginable tax cut would have any impact on their decision to retire outside of Maine.

Similarly, households with very low incomes will not be affected much by tax policies, because they will pay relatively little in taxes (especially income taxes) no matter where they reside. To an even greater extent than middle-income retirees, their locational decisions are likely to be dominated by their preferences, because their circumstances are such that the tax differences across locations are immaterial.

By contrast, consider a fortunate couple contemplating retirement with a net worth in the tens or hundreds of millions of dollars. Here, their *circumstances* are likely to imply such large differences in tax bills across locations that it will be hard for their preferences to win out. Such a household will have substantial post-retirement income, and may face a one-time event from the sale of a business or assets that will create a very large amount of taxable income. For such a couple, the tax differential between Maine and several other states (one of them immediately adjacent; another with warm winters) will be enormous. In many cases the differential may be so large that nothing but radical revisions to Maine's tax system is likely to make much difference in their formal state of residence. Unless Maine is prepared to emulate the zero income tax rate of some of its sister states, very wealthy people (unless their preference for Maine citizenship is exceptionally strong, or their interest in transferring wealth to later generations is exceptionally weak) will shift their formal residence to another state. Modest reductions in tax differentials will not matter much.

So who *might* be affected by a modest change in tax rates? People with *moderate* amounts of income and assets, whose preference for Maine citizenship is weak enough to be counter-balanced by the financial calculations about tax payments. These households are in circumstances that make tax differentials material, and have preferences that are not so strong as to overrule those tax differentials. It is this group–a narrowly defined subset of retirees or prospective retirees—whose location decisions could be affected by a moderate change in Maine's tax system.

But in order to affect the decisions of such households—who, like the price-sensitive airline passengers in the analogy above, can be hard to identify—Maine would have to give a tax reduction to taxpayers with a stronger preference for retiring in Maine. The high-income taxpayers won't be much affected – they will shift their formal residence anyway. The low-income taxpayers won't be much affected–they will stay or go as their preferences dictate, but taxes won't matter much because they don't pay much in taxes. The moderate-income households who are strongly committed to Maine won't have their decisions altered–they were staying anyway.

So the problem, from a tax design perspective, is this: To alter the location choices of that sub-group of retirees who might otherwise leave Maine, or avoid settling in Maine, tax reductions will also have to be extended to what is likely to be a larger group of retirees who are committed to Maine. And unless the tax reduction can be narrowly targeted on retirees—a group which is not precisely defined by age—Maine will also sacrifice revenue from a much larger group of non-retired citizens who were not contemplating a move in any event. Figure 16 summarizes this logic.

Figure 16: Predicted Effects of a Modest Income Tax Reduction on Different Groups[22]

Circumstances: → Preferences: ↓	*Low income/wealth*	*Moderate income/wealth*	*High income/wealth*
Strongly prefer Maine	No change: will stay either way	No change: will stay either way	Little change: may stay either way or go either way
Weakly prefer Maine	No change: will likely stay either way	Some change: may stay if taxes are reduced; may go if not	No change: will leave either way
Prefer other location(s)	No change: will leave either way	No change: will leave either way	No change: will leave either way

[22] Figure 16 is framed in terms of a current resident deciding whether to stay in Maine once retired, but the same logic applies (with slightly different wording) to an out-of-stater considering Maine as a retirement residence.

Clues to the Impact of Maine's Income Taxation

Two of the categories in Figure 16 *do* show significant responsiveness to taxation—the moderately well-off with a real but not absolute preference to retire in Maine, and affluent people with a stronger preference to retire in Maine. Are these two groups large enough, and responsive enough to tax differentials, that a moderate-to-large income tax cut would lead to major changes in the number of retirees residing in Maine? The only way to know this for sure, perhaps, would be a national program of interrogation under hypnosis to learn how much taxes *really* matter, relative to Maine's many virtues. But fortunately (for purposes of analysis, at least) Maine's tax system is sufficiently extreme that some strong hints about the impact of taxation on retirement location can be harvested by milder means. The tax differential between Maine and other states is large enough that if income taxes were major determinants of many retirement location decisions, that effect should show up fairly clearly in patterns of migration. In particular, both the top destination for migrating retirees (Florida) and one of Maine's neighbors (New Hampshire) offer radically different tax systems that are on balance less burdensome for higher-income retirees. We have a sort of natural experiment—not perfect, perhaps[23] but clean enough for confidence that if taxation has a big impact on retirement location decisions, this impact should be discernible in the data.

We have employed three types of data for this purpose—demographic information from the Census Bureau; summaries of tax-return data from the U.S. Internal Revenue Service; and a special analysis of selected state income tax returns conducted by Maine's Revenue Services.[24] The three data sources allow us to triangulate on the question of whether Maine's high income-tax levels are a major deterrent to attracting or retaining retirees, especially higher-income retirees.

Evidence from Census Data

The 1990 Census collected information on where respondents had been living five years previously. We obtained a random sample of one percent of 1990 Census responses. This is one percent of roughly a hundred million responses, so the sample size is large enough to identify major features with some reliability.[25]

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[23] We would know more, for example, if Maine and New Hampshire had maintained similar tax systems for a long time, and then diverged sharply a decade ago. Since the differences are long-standing, the two states' populations probably vary in their responsiveness to taxation, so they don't present a clean comparison of the impact of different tax regimes.

[24] The Census data were analyzed by Stephen Minicucci. The IRS analysis was supplied, and the Maine Revenue Services analysis directed, by Michael Allen, whose extensive assistance is gratefully acknowledged. All Maine and IRS data were aggregated before they were provided to us, to ensure the protection of taxpayer confidentiality.

[25] Some of the details—such as migration rates by age and income in a single state—suffer more from potential sampling error. The sample is from Steven Ruggles and Matthew Sobek *et al*, Integrated Public Use Microdata Series, Version 2.0, Minneapolis Historical Census Projects, University of Minnesota, 1997, accessed at www.ipums.umn.edu between June and September 1999 by Stephen Minicucci.

Interstate moves are relatively rare events. A majority of Americans had the same address in 1990 as they had in 1985. (Nationwide, 54.8 percent of the sample had the same address. Mainers were slightly more rooted than average, with 57.3 percent staying put for the five-year period.) People who *do* move generally don't go far; most moves are within the same town or close to it. Only 11.1 percent of households lived in a different state from their residence of five years previously. Not surprisingly, younger people are more likely than their elders to move from one state to another, transplanted by educational or career opportunities or by marriage. Nearly 17 percent of households headed by someone younger than 45 made an interstate move, compared to 8 percent of those between 45 and 54, 5.7 percent of those between 55 and 64, 4.8 percent of those between 65 and 74, and 3.1 percent of those older than 75.

A 1995 Census Bureau report based on the entire Census—rather than the sample we use for the more detailed analysis—found the following demographic pattern for Maine between 1985 and 1990:

Migration into Maine from other states:	132,006
Migration from Maine to other states:	98,668
Net international migration to Maine:	10,773

Over that period, then, about 33,000 more people left other states to live in Maine than left Maine for another state, in addition to the net gain of 10,773 from other countries. This is better than losing population, to be sure, but if we hope to understand the specific impact of taxes on retirees' location decisions, we need more detail on who came, who left, and where they went. For these details we leave the Census Bureau's full-population report and turn to an analysis of the one-percent sample. Remember, however, that specific numbers cited here should be treated as approximations. The more finely the sample is sliced, the more caution needs to be exercised in drawing inferences about patterns in the broader population.

Within the one-percent sample of the 1990 Census, 524 people who headed Maine households in 1990 had moved from some other state since 1985. The major states of origin for new Mainers were Massachusetts (21 percent), New Hampshire (10 percent), New York (7 percent) and California (5 percent.) At the same time, 338 household heads who were living elsewhere by 1990 had moved from Maine since 1985. The major destinations for these emigrants were Massachusetts (14 percent), Florida (also 14 percent), New Hampshire (12 percent), Virginia, California, and New York (each around 6 percent.)

Extrapolating from the one-percent sample suggests that about 18,600 more *households* moved to Maine than left Maine between 1985 and 1990—consistent with the whole-Census figure of about 33,300 *individuals.* This offers some reassurance that the sample gives a reasonably accurate picture of the ins and outs of the other 99 percent. And it underscores the significance of the finding from the sample that Maine gained population from most states and every region, with one major exception. Many more people in the sample moved *to* Florida than came *from* Florida. If the pattern of the sample reflects the whole population, Maine's net loss to Florida between 1985 and 1990 was roughly 3,000 households.

There is no Census category for "retired," but focussing on Census respondents age 55 and older offers an approximation of people contemplating, or already in, retirement. Within the sample there were 88 Maine households, headed by someone 55 or older, that had been living in another state 5 years earlier. And there were 51 such households living elsewhere that had been living in Maine in 1985. This implies a net gain of 3,700 households headed by older people during the five-year period. Given the small number of older people in the sample, there is a margin of error around this inference, though we can be quite confident that Maine did enjoy a net gain. Over half of the 55-and-older newcomers to Maine had been living in other New England states five years earlier. Of those who had left Maine since 1985, fully 45 percent were living in one state—Florida—in 1990; another 18 percent were living in New England, but outside Maine.

By arranging Maine newcomers and emigrants along two dimensions—55 and older, and under 55; 1990 household income of less than $45,000, and $45,000 and over—it is possible to use the sample data to gain some purchase on a central question: Are better-off retirees *more* likely to leave Maine, and *less* likely to come to Maine, than are less affluent retirees? A strong differential would hint that Maine's high income taxes do indeed repel retirees.

Among Mainers younger than 55 the sample suggests income had no effect on the odds of leaving; the same fraction of both the higher and lower income groups—ten percent—left the state between 1985 and 1990. Among Mainers 55 and older, however, only 2.6 percent of those earning less than $45,000 moved to another state, while 6.2 percent of those earning over $45,000 emigrated. This is a large enough difference to be statistically significant (even with so small a sample.) While there may also be reasons other than taxes for this pattern—richer retirees may be able to keep a Maine home even if they legally reside elsewhere, for example—this result hints that taxes may indeed matter to retirees.

This hint is complicated, however, by looking at older people who *came* to Maine between 1985 and 1990. Less-affluent newcomers increased Maine's population of older people earning less than $45,000 by 5 percent during this period. At the same time, newcomers older than 55 and earning more than $45,000 increased Maine's population of affluent older households by 7.4 percent.

The sample comparisons, summarized in Table 2, suggest that Maine is an appealing destination for both high-income and low-income older people. It increased its population of less-affluent older people by a larger amount: The number of poorer seniors increased by 2.4 percent, and of richer seniors by 1.2 percent. But Maine's advantages were apparently great enough to outweigh high taxes for many higher-income retirees, whether they originated in Maine or came from elsewhere, as it recorded a net gain even among households who would be subject to the top income tax rate.

Table 2

Households heads 55 or older in 1990	*Left Maine for another state between 1985 and 1990*	*Came to Maine from another state between 1985 and 1990*
1990 income under $45,000	**2.6 percent**[26]	**5.0 percent**
1990 income $45,000 or over	**6.2 percent**	**7.4 percent**

This is comforting, though far from conclusive. For one thing, the small sample size makes it hazardous to reach firm conclusions based on this Census sample alone. (The net gain of high-income older households in the one-percent sample was a grand total of three.) One way to gain some confidence that taxes do not pose a major deterrent to retirement in Maine is to compare the pattern in Maine with the pattern in New Hampshire. The two states are comparable in climate and geography, and not too radically dissimilar in culture. But they differ fundamentally in tax policy. Maine's taxes are about as tilted toward the top as any in the nation, while New Hampshire (with no income tax) spares high earners and funds its austere public sector largely through local property taxes. If taxes matter greatly in retirement location decisions, we should expect to see *fewer* affluent older people leaving New Hampshire, and *more* choosing to settle in New Hampshire, than we see in Maine.

Table 3

Households heads 55 or older in 1990	*Left New Hampshire for another state between 1985 and 1990*	*Came to New Hampshire from another state between 1985 and 1990*
1990 income under $45,000	**7.1 percent**[27]	**9.1 percent**
1990 income $45,000 or over	**5.8 percent**	**6.5 percent**

Table 3 summarizes the demographic story. New Hampshire *does* seem to lose a smaller fraction of its more affluent older people than Maine. But the difference—5.8 percent of the 1985 baseline versus 6.2 percent—is quite small, and nowhere near statistical significance. At

[26] The denominator is the number of 1985 Maine residents who were over 55 and still alive in 1990 for each income level—1389 with incomes under $45,000, and 242 with incomes $45,000 and over.
[27] The denominator *here* is the corresponding baseline of 1985 older New Hampshire residents—982 with incomes under $45,000, and 308 with higher incomes.

the same time, New Hampshire increased its population of high-income older households by a little *less* than Maine. And New Hampshire, unlike Maine, attracted less-affluent older households at a higher rate than more-affluent older households.

The limitation of the sample data should be kept in mind, and it would be misleading to declare that high-tax Maine has been proven more attractive to affluent retirees than low-tax New Hampshire. It could be that if taxes were equal between the two states, Maine would have increased its population of high-income older people at ten times the rate of New Hampshire, instead of outpacing it by a narrow margin. But the Census data do challenge the proposition that Maine's tax levels are a major deterrent to higher-income retirees.

Evidence from Maine and Federal Tax Returns

To supplement the Census data, we enlisted the cooperation of Maine Revenue Services in using tax-return records to explore the entry and exit of higher-income people. Michael Allen shared with us an analysis of U.S. tax data prepared by the Internal Revenue Service, and another prepared by his own office. Compared to the Census data these analyses are more recent, more detailed, and look at entire populations rather than a sample.

The IRS analysis matched taxpayers' 1996 and 1997 Federal tax returns and recorded (among other things) the number and characteristics of taxpayers who moved between states during the year. A total of 14,767 people who had been Maine residents in 1996 filed their taxes as residents of a different state in 1997. And a total of 13,718 people who lived elsewhere in 1996 filed as Mainers in 1997. This represents a net loss of nearly 1,050 for that particular one-year interval. But this covers *all* taxpayers—young and old, rich and poor. The IRS analysis does not categorize taxpayers by age or retirement status. But it *does* calculate the income reported by both newcomers to and emigrants from each state. Taxpayers who had *left* Maine reported median adjusted gross income of $18,082 the following year; taxpayers who *moved* to Maine reported median adjusted gross income of $20,843. So while the IRS data indicate that Maine *did* lose people, on balance, over that one-year period, the people it gained earned more than the people it lost. Interstate migration seems to have *increased* personal income in Maine by about $36 million. The IRS data tell us nothing about retirees, but do call into question the notion that Maine's high income taxes are repelling high earners in general.

Finally, Maine Revenue Services did a simple analysis of Maine tax returns looking directly at high-income older people. The approach was straightforward: Identify all of the tax returns filed in 1997 by residents older than 65 and reporting tax liability over $5,000—representing income in the range of $100,000 and above. Then see which of those high-income older taxpayers did *not* file the next year. Similarly, identify high-income older people who filed in 1998 but had not filed the previous year. If high-income retirees tend to leave the state, or avoid coming to the state, the first group should be larger than the second group. But in fact, Maine Revenue Services found that "new" high-income older taxpayers outnumbered "lost" high-income older taxpayers by more than two to one. (There were 150 "new" returns and 72 "lost" returns.) This is another piece of evidence, consistent with the IRS analysis and the Census data, casting doubt on the idea that high earners are being charged a prohibitive price for the privilege of Maine citizenship.

This is not to say that Maine's taxes do not repel *some* potential retirees. There are certainly some people who would like to retire in Maine—and whom Mainers would like to have as neighbors—who are deterred by the prospect of Maine taxation. A high-income retiree with homes in both Maine and Florida, for example, would pay an enormous price for the privilege of Maine citizenship. Enacting a large enough reduction in the top marginal income tax rate would almost certainly increase the population of affluent retirees. But the evidence suggests that high-earning older people tend not to put tax differentials at the top of the list as they decide where to spend their retirements. It is thus unlikely that the size of the retiree population will prove highly responsive to changes in tax levels.

Concluding Comments

We are neither equipped nor (as outsiders) entitled to call for specific changes in Maine's tax law. But our findings do suggest a few observations that may prove relevant as Mainers reflect on whether, and how, they should alter the financial obligations they place upon themselves and each other.

There are perfectly reasonable objections to tilting the tax burden so strongly towards the top of the income scale. Maine's tradition of highly progressive taxation is certainly out of synch with national trends in state tax policy. There may be arguments compelling to Mainers for reducing this burden—across the board, or only for those above a certain age. But this should not be done with the expectation of dramatically increasing Maine's appeal to retirees.

For the majority of older people—even those with relatively high incomes—taxes appear to be secondary considerations in their choice of residence. Given the state's special virtues, the "price" of being a Mainer is seen as worth paying by many current and prospective retirees. There *are* those, to be sure, who find the price of Maine citizenship to be prohibitive. Some of these have only a mild preference for Maine residence; others face very large tax differentials. But for those whose location decisions *are* driven by income tax liability—particularly retirees with very high incomes—tinkering with the tax code is not likely to change their minds. It would take very large reductions in their tax liability, with correspondingly large implications for how Mainers finance their public sector.

Both anecdotal and statistical evidence point to Florida—which differs radically from Maine in culture, climate, and fiscal structure—as the most common destination for those who choose to abandon Maine in retirement. Most Mainers don't shift their residence to Florida when they retire. Most of those who *do* aren't primarily motivated by taxes. Some, however, would prefer not to retire in Florida, but choose to do so for tax reasons. The point to emphasize is that altering the choices of this "hard core" of tax refugees almost certainly requires more than minor reductions in the current 8.5-versus-zero percent income tax rate differential. Unless this differential is eliminated, or narrowed dramatically, those who avoid Maine for tax reasons will continue to do so. Even if taxes are reduced, those who avoid Maine for reasons *other than* taxes will also continue to do so. And those who find the current tax burden a fair price for Maine citizenship would contribute less than they are willing to pay. This reduction in revenues is likely to be large relative to the broader benefits to Maine. This is not because high-earning retirees fall short as neighbors and fellow citizens; they surely offer benefits to other Mainers, including but going well beyond the taxes they contribute. Rather, it is because the number of decisions changed by anything but a radical fiscal restructuring would probably be small.

The net payoff to Maine would be improved by restricting any higher-income tax reductions to older Mainers. Less tax revenue would be sacrificed (in the form of tax cuts for people who had no intention of leaving) for each older person whose retirement location decision turned out to be altered by the tax cut. But most older Mainers *already* retire in Maine—even those with higher incomes—and Maine seems to enjoy a healthy inflow of well-off retirees. So there is not much reason for confidence that even an age-targeted tax break could be introduced without a significant sacrifice of tax revenue. At the same time, age differentials in tax treatment might be seen as unfair, and would likely introduce complexities and inefficiencies into the tax system.[28]

There are ways to rearrange the tax burden on wealthier Maine retirees—without necessarily reducing that burden—so as to encourage part-time Mainers to be residents rather than vacationers. For example, Maine could introduce a state property tax, structured to effect only the most valuable residences, that would be wholly offset by an income-tax credit. This would leave wealthy Maine residents with the same total tax burden as before, while reducing incentives to emigrate. But such a tactic would complicate the tax code, would be difficult to target precisely, could invite unintended consequences, and may be seen as unfair. Moreover, since many of the benefits retirees bring to Maine (other than income taxes) do not depend on their formal citizenship, promoting residence *per se* may not be so vital a goal as it might seem.

There *is* a reasonable argument for identifying exceptional cases where the “price” of being a Mainer seems both prohibitive and unfair. (This is analogous to an airline defining special categories of passengers for whom regular ticket prices are inappropriate, such as small children, clergy members, or the bereaved.) One such exceptional case may involve the sale of a closely-held business. The value stored up through the labor of many years—even a lifetime—can be turned into taxable capital gains in a single transaction. This sudden spike in tax liability could quite plausibly inspire even the most loyal Mainer to change his state of residence for the year such a transaction occurs. This is typically late in life, as retirement decisions are being made. Such tax-inspired emigration may turn out to be permanent, to the detriment of both the tax émigré and the State of Maine.

This exceptional circumstance could warrant exceptional provisions, such as a one-time opportunity to spread out over five to ten years the capital gains from sale of a proprietorship or partnership, or a large ownership stake in a public corporation in which the taxpayer has played an active role. It may also be worth considering a partial exclusion of the annual allocation of capital gains liability for each year of Maine citizenship following the sale of a business.

[28] For example, an entrepreneur might delay selling her business—even if she is ready to retire, and even if the business would be better run in other hands—until she reached the age of eligibility for lower tax rates. New rules would have to be drafted and enforced regarding the tax treatment of couples of different ages, where one partner is eligible for the lower tax rate and the other is not. More broadly, not everyone will endorse better-off retirees as the top priority for a tax reduction. Recall that the Census sample found that younger and less affluent people were more likely to leave Maine (and also more likely to enter Maine) than older people.

Sophisticated taxpayers can already accomplish some of this by the way they structure their asset transfers. But the state may want to make it easier for less sophisticated Mainers to *remain* Mainers as they make the transition from entrepreneur to retiree.

There may be other such special cases, evident to insiders, in which the residence decisions of some identifiable sub-group of taxpayers are disproportionately effected by the tax system. It may prove possible to craft special provisions to eliminate or soften unwarranted incentives to forsake or avoid Maine residence. In each such case, however, it is important to recognize the costs of tax-code complexity, and balance them against the benefits of more appropriate treatment for exceptional sub-groups. Each increment of complexity in the tax system tends to impose new administrative burdens on government and citizens alike; open avenues (often unanticipated) for abuse; and introduce new risks for real or perceived unfairness.

As the budget permits, it may also be worth considering more liberal tax treatment for retirement income in general. As noted, Maine is less generous than most other states in its taxation of public and private pension income, and (as the Appendix shows) many states have been targeting recent tax reductions on retirees and older citizens. While there is little reason to expect major surges in resident retirees as a consequence, there may well be modest effects in this direction induced by partial exclusions of pension income or age-based income tax preferences. There may also be other justifications (aside from the hope of influencing location choices) for putting some priority on older citizens if and when Maine considers major tax cuts.

There may be good reasons for Mainers to revisit the form of their tax system and the distribution of its burdens across different groups—young and old, working and retired, individuals and corporations, residents and non-residents, property-owners and consumers. The currently benign fiscal environment may offer citizens and their representatives an opportunity to reflect on whether the *status quo* in tax policy faithfully embodies Maine's values. Such reflection may or may not inspire changes that move Maine closer to the pattern other states have chosen, or to contemporary trends in tax reduction. But we suggest that only for exceptional and narrowly defined cases should such changes be enacted with the expectation of exerting much leverage over location decisions.

APPENDIX

State Income Tax Reductions Enacted 1995 through 1998

This Appendix summarizes all major income tax reductions—defined as those with bringing about a net decline in taxpayer liability of $50 million or greater—enacted by state legislatures each year from 1995 through 1998. This period represents four sequential years of net state tax reductions, following nine years of net state tax increases. In addition to listing the *largest* income tax reductions, the appendix also includes *any* 1995-98 income tax reductions specifically targeted to (or disproportionately affecting) retirees or older taxpayers. (These entries are shaded.)

Source: National Conference of State Legislatures, Denver and Washington D.C., *State Tax Actions*, annual issues

Tax Reductions Enacted in the 1995 Legislative Session

State	Tax Reduction Summary	Estimated Revenue Reduction (in $million) by fiscal year(s)
Arizona	Adopted family tax credit ($30 per exemption up to $120 per family); increased the standard deduction (from $3500 to $3600 single and $7000 to $7200 joint) and cut rates as follows: 3.25 cut to 3.00; 4.0 cut to 3.5; 5.05 cut to 4.2; 6.4 cut to 5.2; and 6.9 cut to 5.6.	$200 '96
California	Allowed temporary individual rate increase to expire, with rates falling from 11% (for incomes over $200K) and 10% (for incomes over $100K) to a combined top rate of 9.3%	$255 '96 $643 '97

Connecticut	Created new 3% rate for first $4,500 single/$7,000 head of household/$9,000 joint in taxable income. Adopted credit for up to $400 in local property taxes paid	$6 '96 $100 '97 $100 '97
Delaware	Reduced tax rates as follows: from 6.6% to 6.35% on taxable income between $20K and $25K; from 7 to 6.65% between $25K and $30K; from 7.6 to 7.1% between $30Kand $40K; and from 7.7% to 7.1% for taxable income over $40K	$11.3 '96
Iowa	Adopted pension exclusion of $3,000 for single filers, $6,000 for joint filers Adopted 100% deduction for health insurance costs	$22 '96
Kentucky	Adopted four-year phase-in of exclusion for private pensions and IRAs; CY '95, 25% exclusion capped at $6,250; CY '96, 50% capped at $12,500; CY '97, 75% capped at $18,750; CY '98 and thereafter, 100% capped at $35K	$9 '95 $27.1 '96
Michigan	Increased personal exemption from $2,100 to $2,400 in CY'95 and CY '96 and to $2,500 in CY'97	$69 '95 $91 '96
New Jersey	Adopted an additional 3% to 15% reduction in marginal tax rates; rate reductions range from low bracket reduction from 1.7% to 1.4% to highest bracket reduction from 6.58% to 6.37%	$259 '96 $600 '97

North Carolina	Increased the personal exemption from $2K in '94 to $2,250 in '95 and $2,500 in '96 and beyond; adopted a $60 per dependent child credit for taxpayers with incomes below $100K (joint return)	$235 '96 $244.1 '97
Ohio	Increased personal and dependent exemptions as follows: taxpayer and spouse--from $650 to $750 in tax year '96 and $850 in '97; dependents—from $650 to $850 in '96 and $1,050 in '97	$0 '96 $69 '97
Virginia	Modified the age deduction: old deduction was $14,933 minus Social Security income for taxpayers 65 and over and $7,466 minus S.S. income for taxpayers 62-64; new deduction is $10K (65 and over) and $5K (62-64) in CY'95 and $12K (65 and over) and $6K (62-64) in CY'96 and thereafter (1994 special session)	$8.5 '95 $26.2 '96

Tax Reductions Enacted in the 1996 Legislative Session		
State	**Tax Reduction Summary**	**Estimated Revenue Reduction**
Massachusetts	Increased standard deduction from $2,200 per person to $2,860	$150 '97
Michigan	Increased interest and dividend exemption for senior citizens as follows: for single returns, from $1K to $3.5K in '97 and $7,5K in '98; for joint returns, from $2K to $7K in '97 and $15K in '98	$18 '97
New Jersey	Adopted deduction for property taxes paid (or rent equivalent) of up to $10K and adopted tax credit for persons with little or no tax liability (phased in over 3 years)	$100 '97
New York	Continued multiyear reduction; top rate falls from 7.5% to 7.0% on 1/97 and standard deduction increases from $6,6K to $7.4K/single, from $8,150 to $10K/head of household and from $10,8K to $12,380/joint ('95 legislation	$1,700 '97
North Carolina	Allowed nonrefundable income tax credit for tax paid on federal pensions in the '85-'88 tax years	$35.5 '97
Ohio	Provided a 6% to 6.5% (contingent on revenues) across-the-board reduction in rates.	$375 '97
Oklahoma	Adopted a $5.5K private pension exclusion, phased in over 5 years	$1.7 '97

Tax Reductions Enacted in the 1997 Legislative Session		
State	**Tax Reduction Summary**	**Estimated Revenue Reduction**
Arizona	Reduced single rates from 3.0% to 2.9% of incomes $0 to $10K; from $300 plus 3.5% to $290 plus 3.3% on incomes $10,001 to $25K; from $825 plus 4.2% to $785 plus 3.9% on incomes $25,001 to $50K; from $1875 plus 5.2% to $1760 plus 4.8% on incomes $50,001 to $150K; from $7075 plus 5.6% to $6560 plus 5.17% on incomes over $150K. Reduced single head of household and married joint rates from 3% to 2.9% for incomes $0 to $20K; from $600 plus 3.5% to $580 plus 3.3% for incomes $20,001 to $50K; from $1650 plus 4.2% to $1570 plus 3.9% for incomes $50,001 to $100K; from $3750 plus 5.2% to $3520 plus 4.8% for incomes $100,001 to $300K; and from $14150 plus 5.6% to $13120 plus 5.17% for incomes over $300K	$110.8 '98
Connecticut	Exempted one half of 50% of Social Security income	$1.0 '98 $10.0 '99
Delaware	Liberalized the definition of income qualifying for the $3,000 pension income exclusion for ages 60+	$2.0 '98
Iowa	Reduced marginal rates 10% across the board; formerly ranged from 0.4% to 9.99%; now 0.36% to 8.98%	$103.0 '98 $200.0 '99

Maine	Repealed the revenue cap as of 7/97; increased the personal exemption from $2,100 to $2,150 and removed low-income filers from rolls as of 1/97	$43.8 net increase '98
Massachusetts	Adopted a temporary increase in personal exemption to return $84 million to taxpayers; one-time impact	$84.0 '98
Missouri	Began phase-in of a deduction for private-source retirement benefits	$2.0 '98
Nebraska	Reduced rates for TY '97 and TY '98 as follows: from 2.62% to 2.51%; 3.65% to 3.49%; 5.24% to 5.01%; and 6.99% to 6.68%. Increased personal exemption credit by $10.	$82.7 '98
North Dakota	Provided a credit of up to $4K for in-home care to avoid nursing home confinement	No estimate '98
Ohio	Authorized tax preferences for medical savings accounts	$3.3 '98
Ohio	Made permanent across the board rate reductions as a result of general fund surpluses.	$256.2 '98
South Carolina	Increased the maximum deduction to $11,500 for people 65 and older	$2.7 '98
Wisconsin	Conformed to federal IRC by (1) excluding from income amounts received under long-term care insurance contracts, and (2) adopting medical savings accounts provisions	$6.1 '98

Tax Reductions Enacted in the 1998 Legislative Session		
State	**Tax Reduction Summary**	**Estimated Revenue Reduction**
Arizona	Raised the minimum personal income tax threshold and reduced tax rates across the board, averaging 2.5 percent over two years.	$30 '99 $50 '00
California	Adopted a personal income tax renter credit of $120 for joint filers whose incomes are less than $50K and $60 for single filters whose incomes are less than $25K Increased the personal income tax dependent credit from $120 to $253 in 1998 and from $222 to $227 in 1999	$133 '99 $141 '00 $612 '99 $22 '00
Connecticut	Increased the levels of taxable income subject to the 3% tax rate from $15K to $20K for joint filers; from $12K to $16K for heads of households; and from $7.5K to $10K for single filers. Withholding tables will be adjusted beginning July 1998 so that the revenue loss occurs in FY 1999.	$75 '99 $92 '00
Delaware	Increased the pension income exclusion from $3K to $5K for those age 60 and older	$0 '99 $5.1 '00

Delaware	Increased the standard deduction for single taxpayers from $1,300 to $3,250 and for married filing singly from $800 to $2K Reduced personal income tax rates from: 3.1% to 2.6% on incomes from $2K to $5K; from 4.85% to 4.3% on incomes from $5K to $10K; from 5.8% to 5.2% on incomes from $10K to $20K; from 6.15% to 5.6% on incomes from $20K to $25K; from 6.45% to 5.95% on incomes from $25K to $30K; and from 6.9% to 5.95% on incomes from $30K to $60K and on incomes over $60K	$8 '99 $17 '00 $37.9 '99 $96.8 '00
Georgia	Increased the retirement exclusion from $12K to $31K	$8.6 '99
Georgia	Increased the personal exemption from $1,500 to $2,700; increased the dependent exemption from $2,500 to $2,700; and increased the deduction for those age 65-plus and for blind people from $700 to $1,300.	$205 '99 $209 '00
Hawaii	Reduced personal income tax rate from 10% to 8.757%	$80 '99 $159 '00

Illinois	Began phasing in an increase in the personal income tax exemption from $1K to $2K: exemption will increase to $1,300 in TY 1998; to $1,650 in TY 1999 and to $2K in TY 2000.	$96 '99
Iowa	Adopted a capital gains exemption for business sales. Increased the pension income exclusion.	$18 '99 $18.5 '00 $20 '99 $18 '00
Massachusetts	Adopted a permanent increase in the personal exemption. Adopted a temporary increase in the personal exemption to expire Jan. 1, 1999. Lowered the rate on interest and dividends from 12% to 5.95%.	$320 '99 $440 '00 $200 '99 $177 '99 $238 '00
Missouri	Increased the senior citizen/disabled veteran property tax credit. Increased to $1K the deduction for dependents older than age 66.	$21 '99 $21 '00 $3 '99 $30 '00

Nebraska	Adopted permanently the 5% temporary rate reductions passed in 1997; increased the personal exemption credit by $10; and made self-employed health insurance premiums fully deductible. Also increased the refundable child care credit for adjusted gross income below $22K.	$27.6 '99 $75.2 '00
New Jersey	Excluded military and survivor pensions from personal income tax.	$5.3 '99 $5.5 '00
North Carolina	Adopted a temporary credit of 15% of long-term care insurance premiums, with a maximum of $350 per policy, to expire in 2004.	$0 '99 $8 '00
Pennsylvania	Excluded from personal income gains on the sale of a principal residence. Increased the "poverty" exemption.	$30 '99 $31.5 '00 $57.1 '99 $49 '00
Wisconsin	Reduced personal income tax rates by 1.5%: from 4.85% to 4.77%; from 6.48% to 6.37%; from 6.87% to 6.77%.	$83.4 '99 $83.4 '00
Maine *(This information was not included in the NCSL tax data, but the omission was corrected for us by Michael Allen of Maine Revenue Services.)*	Additional increases in personal exemption and introduction of homestead exemption	around $35 million in both '98 and '99